EDITOR'S NOTE

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. 84-1274-CFX
atus: GRANTED

Title: Board of Governors of the Federal Reserve System, Petitioner
v.
Dimension Financial Corporation, et al.

cketed:
bruary 6, 1985

Court: United States Court of Appeals for the Tenth Circuit

Counsel for petitioner: Mattingly Jr., James V.

Counsel for respondent: Davidson, Jeffrey S., Ridgley, Thomas E., Blount Jr., James D., Hawke Jr., John D.

try	Date	Note	Proceedings and Orders
1	Dec 12 1984		Application for extension of time to file petition and order granting same until January 22, 1985 (White, December 13, 1984).
2	Jan 11 1985		Application for further extension of time to file petition and order granting same until February 6, 1985 (White, January 14, 1985).
3	Feb 6 1985	G	Petition for writ of certiorari filed.
4	Mar 7 1985		Brief of respondents Dimension Fin. Corp., et al. in opposition filed.
5	Mar 7 1985		Lodging received.
6	Mar 13 1985		DISTRIBUTED. March 29, 1985
7	Mar 22 1985	X	Reply brief of petitioner Bd. of Governors of the Federal Reserve System filed.
9	Apr 5 1985		REDISTRIBUTED. April 12, 1985
1	Apr 22 1985		REDISTRIBUTED. April 26, 1985
2	Apr 29 1985		Petition GRANTED. Justice White OUT.
			**
3	May 31 1985		Record filed.
4	May 31 1985		Certified original record and C. A. proceedings received. (Box).
6	May 31 1985		Order extending time to file brief of petitioner on the merits until July 13, 1985.
7	Jul 12 1985		Brief of petitioner Bd. of Governors of the Federal Reserve filed.
8	Jul 11 1985		Brief amicus curiae of Independent Bankers Association of America filed.
9	Jul 13 1985		Brief amicus curiae of Conference of State Bank Supervisors, et al. filed.
0	Jul 17 1985		Joint appendix filed.
2	Jul 29 1985		Order extending time to file brief of respondent on the merits until August 28, 1985.
3	Aug 14 1985		Order further extending time to file brief of respondent on the merits until September 11, 1985.
4	Aug 14 1985		Above extension applies to all respondents. No further extension will be granted.
5	Sep 11 1985		SET FOR ARGUMENT. Monday, November 4, 1985. (4th case).
6	Sep 11 1985		Brief of respondents American Financial Services Assn., et al. filed.
7	Sep 11 1985		Lodgings received.
8	Sep 11 1985		Brief of respondents Dimension Financial Corporation, et al.

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. 84-1274-CFX

try	Date	Note	Proceedings and Orders
			filed.
9	Sep 11 1985		Brief amicus curiae of United States filed.
0	Sep 11 1985		Brief amicus curiae of Sears, Roebuck and Co., et al. filed.
1	Sep 16 1985		CIRCULATED.
2	Sep 26 1985	G	Motion of respondents for divided argument filed.
3	Oct 15 1985		Motion of respondents for divided argument GRANTED. Justice White OUT.
4	Oct 15 1985		Application for leave to file a reply brief in excess of the page limitation filed (A-286), and order granting
5	Oct 15 1985		same by Marshall, J., on Oct. 15, 1985. The brief may not exceed 25 pages.
6	Oct 22 1985	X	Reply brief of petitioner Bd. of Gov., Federal Reserve filed.
7	Oct 18 1985		Application for leave to file a reply brief in excess of the page limits filed (A-286), and order granting
8	Oct 18 1985		same by Marshall, J., on Oct. 18, 1985. The brief may not exceed 27 pages.
9	Nov 4 1985		ARGUED.

84-1274 (1)

No.

In the Supreme Court of the United States

OCTOBER TERM, 1984

BOARD OF GOVERNORS OF THE
FEDERAL RESERVE SYSTEM

v.

DIMENSION FINANCIAL CORP., ET AL.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE TENTH CIRCUIT

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QUESTION PRESENTED

Section 2(c) of the Bank Holding Company Act of 1956 (12 U.S.C. 1841(c)) defines a "bank" as any institution that "(1) accepts deposits that the depositor has a legal right to withdraw on demand, and (2) engages in the business of making commercial loans." The question in this case is whether the Federal Reserve Board properly exercised its discretion in determining that the first prong of this definition includes deposits that as a matter of universal practice are paid on demand, and that commercial lending includes the purchase of commercial paper, retail installment loans, and similar money market instruments.

PARTIES TO THE PROCEEDING

In addition to the parties named in the caption, Daniel T. Carroll, Harold D. Dufek, William T. Mitchell, Ronald L. Shaffer, A. Gary Shilling, the State of Ohio, Ohio Division of Savings and Loan Associations, Ohio Deposit Guarantee Fund, Horizon Savings and Loan Company, Permanent Savings and Loan Association, Financial Institutions Assurance Corporation, First Bancorporation, Colorado Industrial Bankers Association, Fort Lupton Industrial Bank, Monroe Industrial Bank, Castle Rock Industrial Bank, Art Valley Industrial Bank, Household Weld County Industrial Bank, Household Lamar Industrial Bank, Household Alamosa Industrial Bank, Household Valley Industrial Bank, Household Salida Industrial Bank, Copper State Thrift & Loan Company, and Copper State Financial Corporation were petitioners in the court of appeals. American Financial Services Association and Household Finance Corporation were intervenors in the court of appeals.

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In the Supreme Court of the United States

OCTOBER TERM, 1984

No.

BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM

v.

DIMENSION FINANCIAL CORP., ET AL.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE TENTH CIRCUIT

The Solicitor General, on behalf of the Board of Governors of the Federal Reserve System, petitions for a writ of certiorari to review the judgment of the United States Court of Appeals for the Tenth Circuit in this case.

OPINION BELOW

The opinion of the court of appeals (App., *infra*, 1a-19a) is reported at 744 F.2d 1402.

JURISDICTION

The judgment of the court of appeals was entered on September 24, 1984. On December 13, 1984, Justice White extended the time for filing a petition for

a writ of certiorari to January 22, 1985. On January 14, 1985, Justice White further extended the time for filing to and including February 6, 1985. The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

STATUTORY AND REGULATORY PROVISIONS INVOLVED

12 U.S.C. 1841(c) provides in relevant part:

> "Bank" means any institution * * * which (1) accepts deposits that the depositor has a legal right to withdraw on demand, and (2) engages in the business of making commercial loans.

12 C.F.R. 225.2(a)(1) provides:

> "Bank" means any institution organized under the laws of the United States that:
>
> (i) Accepts deposits that the depositor has a legal right to withdraw on demand and
>
> (ii) Engages in the business of making commercial loans. For the purposes of this definition:
>
> (A) "Deposits that the depositor has a legal right to withdraw on demand" (hereinafter "demand deposits") means any deposit with transactional capability that, as a matter of practice, is payable on demand and that is withdrawable by check, draft, negotiable order of withdrawal, or other similar instrument; and
>
> (B) "Commercial loans" means any loan other than a loan to an individual for personal, family, household, or charitable purposes, and includes the purchase of retail installment loans or commercial paper, certificates of deposit, bankers' acceptances, and similar money market instruments, the extension of broker call loans, the sale of federal funds, and the deposit of interest-bearing funds.

STATEMENT

1. Section 2(c) of the Bank Holding Company Act of 1956 (BHCA or Act) (12 U.S.C. 1841(c)) defines a "bank" as "any institution * * * which (1) accepts deposits that the depositor has a legal right to withdraw on demand, and (2) engages in the business of making commercial loans." The term "bank holding company," in turn, is used to "mean[] any company which has control over any bank" (12 U.S.C. 1841(a)(1)). The BHCA subjects such companies to extensive regulation. Among other things, bank holding companies may not own or control most types of nonbanking businesses (12 U.S.C. 1843(a) and (c)(8)), may not make interstate acquisitions of banks unless such acquisitions are expressly permitted by state law (12 U.S.C. 1842(d)), and may acquire additional banks only by satisfying the Federal Reserve Board's (Board) public interest and antitrust standards (12 U.S.C. 1842(c)). Bank holding companies also must comply with detailed registration and reporting requirements. 12 U.S.C. 1844(c).

This case concerns the place within the BHCA's regulatory scheme of institutions generally labeled "nonbank banks." Nonbank banks, while largely indistinguishable from banks (and while fully regulated by the Comptroller of the Currency pursuant to the National Bank Act, 12 U.S.C. 21 *et seq.*), have escaped treatment as banks under the BHCA by de-

clining either to accept demand deposits in the form of conventional checking accounts, or to make commercial loans in the form of "face-to-face" lending transactions. See generally App., *infra*, 24a, 25a. Thus, nonbanks typically offer negotiable order of withdrawal (NOW) accounts rather than conventional checking accounts (see *id.* at 32a, 38a-43a); while the depository institution theoretically retains a right to demand notice prior to withdrawal from a NOW account, in practice advance notice never is demanded (see *id.* at 39a-40a), and the NOW account functions as an interest-bearing checking account (see *id.* at 38a-40a).[1] Similarly, a nonbank bank that accepts

[1] NOW accounts are transaction accounts that "operate as demand checking accounts" (App., *infra*, 38a). Like the holder of a conventional checking account, "the holder of a NOW account makes withdrawals by means of a demand draft that may be issued to a third party as a means of transferring funds to the third party from the depositor. The payee of the NOW draft deposits it in the payee's bank for collection from the drawee institution. The drawee institution then charges the depositor's NOW account to pay the draft. * * * NOW drafts are cleared through the Federal Reserve check collection facilities as demand items, exactly like conventional checks." *Ibid.* In addition, NOW accounts "are uniformly advertised as checking accounts" (*id.* at 39a), and empirical evidence suggests that many depositors use NOW accounts as their principal checking accounts (*id.* at 39a n.21). Indeed, depositors have shifted a substantial portion of their funds from conventional checking to NOW accounts (see 67 Fed. Res. Bull. 595, 596 (1981)). The only functional differences between NOW accounts and conventional checking accounts are that NOW accounts are not available to most for-profit depositors (12 U.S.C. 1832(a) (2)) (although they may be used by sole proprietorships (12 C.F.R. 217.157(b)), and, of course, that NOW accounts offer interest.

Banks reserve the right to require notice prior to payment on a NOW account because federal law (12 U.S.C. 371a, 1828(g) (1); 12 C.F.R. 217.2) forbids the payment of interest on demand deposits. The depository institution's reservation of a theoretical right to demand seven days' notice prior to withdrawal prevents a NOW account from becoming a demand deposit within the meaning of the Board's definition of that term as it applies to those provisions (see 12 C.F.R. 217.1(e) (2)), and therefore avoids the interest prohibition. In fact, however, the Board is unaware of a single instance in which a depository institution has invoked a NOW account's notice requirement (App., *infra*, 40a).

demand deposits might invest its funds in commercial paper, federal funds and other money market instruments rather than negotiate face-to-face commercial loans (see App., *infra* 45a-46a).

In early 1984, the Board responded to a dramatic increase in the number of nonbank banks (see App., *infra*, 24a-25a) by amending its existing Regulation Y to ensure that nonbank banks would be treated as banks within the meaning of the BHCA. The Board noted that "NOW accounts in practice perform the same function as conventional demand deposits, are advertised and used in a manner indistinguishable from conventional bank checking accounts, and are subject to the same reserve requirements as conventional demand deposits" (*id.* at 38a). The Board also concluded that the purchase of money market and similar instruments "as a matter of law establish[es] a debtor-creditor relationship and constitute[s] an extension of credit or loan" (*id.* at 46a).

The amended Regulation Y accordingly defines "deposits that the depositor has a legal right to withdraw on demand" (12 U.S.C. 1841(c) (1)) to mean:

> any deposit with transactional capability that, as a matter of practice, is payable on demand and that is withdrawable by check, draft, negotiable order of withdrawal, or other similar instrument * * *.

12 C.F.R. 225.2(a)(1)(A). The regulation defines "commercial loan" (12 U.S.C. 1841(c)(2)) to mean:

> any loan other than a loan to an individual for personal, family, household, or charitable purposes, and includes the purchase of retail installment loans or commercial paper, certificates of deposit, bankers' acceptances, and similar money market instruments, the extension of broker call loans, the sale of federal funds, and the deposit of interest-bearing funds.

12 C.F.R. 225.2(a)(1)(B). The regulation thus includes as a bank within the meaning of the BHCA any institution that offers NOW checking accounts and makes commercial loans.[2] It also treats as a bank any institution that uses its funds to purchase short-term commercial obligations while accepting demand deposits.

2. Some of the issues presented by amended Regulation Y were first addressed by the Tenth Circuit in *First Bancorporation* v. *Board of Governors*, 728 F.2d 434 (1984). The court of appeals there overturned a Board ruling that a Utah industrial loan company offering NOW rather than conventional checking accounts is a bank within the meaning of the BHCA.[3]

[2] The Board noted that other types of transaction accounts also might fall within the definition (App., *infra*, 43a), but explained that "it is unlikely that there would be a significant number of depository institutions offering these accounts that do not also offer NOW or other checking accounts" (*ibid.*). The principal focus of the Board's ruling therefore was on NOW accounts (see *id.* at 32a-45a).

[3] The Board order at issue (*First Bancorporation* (*Beehive Thrift & Loan*), 68 Fed. Res. Bull. 253 (1982)) was the basis for the amendment to Regulation Y (see App., *infra*, 21a). The revised regulation was promulgated before the Tenth Circuit overturned the Board's *First Bancorporation* order.

In reaching its conclusion, the court noted that, under Utah law, industrial loan companies must reserve the right to demand 30 days' notice prior to the withdrawal of funds from a NOW account. 728 F.2d at 435. As a result—even though, as the court acknowledged, "withdrawals from NOW accounts are in actual practice permitted on demand" (*id.* at 436)—the court held that a depositor whose funds are held by a Utah industrial loan company has "no legal right of withdrawal on demand" (*ibid.*). The court also concluded that the statutory language must be interpreted narrowly because Congress used the "legal right to withdraw" formula rather than a broader "payable on demand" test (*id.* at 436-437). The court accordingly held that Utah industrial loan companies do not satisfy the "bank" definition set out in the BHCA.

3. Shortly after the promulgation of amended Regulation Y, respondents filed petitions challenging the regulation in the Fourth, Sixth and Tenth Circuits. These petitions all were transferred to the Tenth Circuit pursuant to 28 U.S.C. 2112(a). That court then invalidated both the demand deposit and the commercial loan aspects of the Board's regulation. On the demand deposit point, the court of appeals relied entirely on its *First Bancorporation* decision (App., *infra*, 4a, 18a).

On the commercial loan issue, the court first explained that "the new definition of [commercial loan] is not in accord with common usage" (App., *infra*, 8a), and that the Board in the past had ruled that an institution may engage in money market transactions without subjecting itself to treatment as a bank (*id.* at 5a-6a). "Such a complete change [in position]," the court opined, "and one that is a redefinition and

expansion of jurisdiction by an agency requires that different standards be met than are demanded in a typical administrative redefinition not involving such elements" (*id.* at 9a). The court also found support for its holding in the legislative history, concluding that the commercial loan proviso was added to the statute specifically to exempt from the BHCA only one institution, the Boston Safe Deposit & Trust Company; yet when the proviso was added, the court stated, Congress and the Board knew that the company was engaging in money market transactions of the sort that revised Regulation Y now treats as commercial loans (*id.* at 10a-11a). And the court noted that other federal agencies have disagreed with the Board's definition of commercial loan (*id.* at 7a, 17a).

Finally, the court of appeals reasoned that the Board "does not have the broad scope to work in as do many other agencies. * * * Instead, the BHCA limits the subject matter of the Board's functions basically to anticompetitive considerations" (App., *infra,* 12a). In combination with the other factors noted above, this consideration led the court to hold that "the limited authority of the Board [does not] permit[] it to itself bring about the change here attempted and a change in its own jurisdiction no matter how necessary it perceives the change to be * * *" (*id.* at 17a). The court of appeals therefore broadly enjoined the Board from implementing or enforcing the revised Regulation Y (*id.* at 19a).

REASONS FOR GRANTING THE PETITION

This case presents a question of paramount importance to the operation and structure of the nation's banking system. Since the enactment of the BHCA in 1956, the structure of that system has been based on

two firm principles: the strict separation of banking from other forms of commerce, and the prevention of undue concentration of control over banking facilities. See *Lewis* v. *BT Investment Managers, Inc.*, 447 U.S. 27, 46 (1980). To a significant degree, the court of appeals' decision would defeat those purposes by allowing the companies that control nonbank banks —which in reality are full-fledged banking institutions—to circumvent entirely the restrictions as to nonbanking activities, interstate operations, partiality in the credit-granting process, and anticompetitive acquisitions that are imposed on bank holding companies by the BHCA.

The legislative history of the Act makes it plain that 12 U.S.C. 1841(c) was not intended to permit such a development. Given this history and the basic statutory purposes—which, in combination, have convinced at least one other court of appeals to accept the Board's approach to the demand deposit aspect of the statutory definition—deference to the Board's expertise in interpreting and effectuating the meaning of the BHCA is entirely appropriate. Yet the Tenth Circuit misread or ignored the relevant legislative history, and failed even to acknowledge the Board's special role in administering most elements of the BHCA. When so flawed an appellate opinion will have such far-reaching consequences, review by this Court is appropriate.

1. The Tenth Circuit avoided any consideration of the consequences of its decision by resting its holding principally on the language of 12 U.S.C. 1841(c). In reading that language narrowly, however, the court improperly assumed that there is an "errorless test for identifying or recognizing 'plain' or 'unambiguous' language." *United States* v. *Turkette,* 452 U.S.

576, 580 (1981). At the same time, the court of appeals disregarded both the congressional intent underlying the BHCA and this Court's direction that, when construing a statute, "authoritative administrative constructions should be given the deference to which they are entitled, [and] absurd results * * * avoided." *Ibid.*

a. The court of appeals' mechanistic approach to the "legal right to withdraw on demand" prong of the BHCA is not compelled by the statutory language and is fundamentally inconsistent with the legislative history. As originally enacted, the BHCA defined a "bank" simply as "any national banking association or any State bank, savings bank, or trust company." Bank Holding Company Act of 1956, ch. 240, § 2, 70 Stat. 133, 12 U.S.C. 1841. The Board interpreted this definition in a functional manner, defining a bank as any institution that either "[1] accept[ed] deposits subject to check or [2] otherwise accept[ed] funds from the public that [were], in actual practice, repaid on demand." 49 Fed. Res. Bull. 166 (1963).[4] Concerns were expressed, however, that the second prong of this definition would lead to the treatment of industrial and savings institutions as banks within the meaning of the Act.[5] See 112 Cong. Rec. 12385

[4] The Board issued its 1963 interpretation in the course of determining whether state industrial banks were "State bank[s]" within the meaning of the BHCA.

[5] These institutions did not offer checking accounts. See 112 Cong. Rec. 12385 (1966) (remarks of Sen. Robertson). They did offer passbook savings accounts, however; withdrawals from such accounts, although subject to advance notice provisions, generally—but not invariably (see App., *infra*, 40a n.23)—are paid on demand. See, *e.g.*, 21 Fed. Res. Bull. 863 (1935). Industrial or savings institutions therefore could have been swept within the second prong of the Board's 1963 definition.

(1966) (remarks of Sen. Robertson); *Amend the Bank Holding Company Act of 1956: Hearings on S. 2353, S. 2418 and H.R. 7371 Before a Subcomm. of the Senate Comm. on Banking and Currency*, 89th Cong., 2d Sess. 155, 157 (1966) (*1966 Hearings*) (testimony of Max A. Denney). Congress—with the Board's endorsement (see *1966 Hearings* 447)—responded to these concerns in 1966 by eliminating the second prong of the Board's test, and defining as a bank any institution that accepts deposits that the depositor has a legal right to withdraw on demand. Pub. L. No. 89-485, § 3, 80 Stat. 236, 12 U.S.C. 1841(c)(1).

While Congress made use of the "legal right to withdraw" formulation rather than a "payable on demand" test proposed by the Board (see *1966 Hearings* 447), it plainly did not intend the statutory term to depart from the first prong of the Board's pre-existing definition. To the contrary, Congress explained that it had adopted "the commonly accepted test of whether an institution is a commercial bank." S. Rep. 1179, 89th Cong., 2d Sess. 7 (1966). In doing so, Congress was concerned not with the legal rights of depositors but with their ability to withdraw funds from their accounts by check. See *Wilshire Oil Co.* v. *Board of Governors*, 668 F.2d 732, 737 (3d Cir. 1981), cert. denied, 457 U.S. 1132 (1982). Thus the hallmark of a "bank," Congress made clear, was whether the "institution * * * accepts deposits payable on demand (checking accounts)" (S. Rep. 1179, *supra*, at 7); indeed, the Senate Report captioned its discussion of the amendment simply "[e]xclusion of institutions that do not accept checking accounts" (*ibid.* (emphasis omitted)). Industrial and savings banks were excluded from the definition because they did "not receive deposits in the form ordinarily re-

ceived by commercial banks" (112 Cong. Rec. 12386 (1966) (remarks of Sen. Robertson))—that is, they did not "accept demand deposits subject to check" (*id.* at 12385 (remarks of Sen. Robertson)).[6]

Institutions offering NOW accounts, however, undeniably do "accept demand deposits subject to check." Even the court of appeals acknowledged (*First Bancorporation*, 728 F.2d at 436) that NOW accounts are, in operation, identical to checking accounts. See App., *infra*, 38a-40a; note 1, *supra*. For its part, the Board has explained that it is unaware

[6] The checking or transactional feature traditionally distinguished savings from other forms of accounts. See, *e.g.*, 21 Fed. Res. Bull. 863 (1935); 13 Fed. Res. Bull. 609 (1927); 9 Fed. Res. Bull. 677 (1923); 1 Fed. Res. Bull. 38 (1915). In its comments prior to the 1966 amendment of the BHCA, the Board urged Congress to retain this test. *1966 Hearings* 447. As the legislative history cited in text demonstrates, that is precisely what Congress did when it defined as a bank any institution that offers transactional "deposits payable on demand (checking accounts)." S. Rep. 1179, *supra*, at 7. This context compels the conclusion that Congress used the "legal right to withdraw language" not because it was concerned about the legal characteristics of the account; instead, Congress chose that term because it provided a shorthand method for excluding from coverage under the BHCA those industrial and savings banks that did not offer checking accounts. See note 5, *supra*. In using its own language rather than the Board's proposed "payable on demand" formulation, then, Congress was not—as the court of appeals believed (*First Bancorporation*, 728 F.2d at 436-437)—rejecting the Board's test. To the contrary, the legislative history describes the enacted language in the very terms the Board proposed, as "deposits payable on demand." In fact, Congress used all of these terms—"checking account," "demand deposit" and "deposit that the depositor has a legal right to withdraw on demand"—interchangeably, without any indication that the BHCA's meaning turned on technical distinctions between the terms.

of a single instance in which a NOW account's notice requirement (the only theoretical distinction between such accounts and other forms of demand deposits) has been invoked by a depository institution (App., *infra*, 40a).[7] And when Congress for the first time approved the nationwide use of NOW accounts in 1980 (Depository Institutions Deregulation and Monetary Control Act of 1980, Pub. L. No. 96-221, § 303, 94 Stat. 146, 12 U.S.C. 1832), it flatly declared that such accounts functioned as both "interest bearing checking accounts" (S. Rep. 96-368, 96th Cong., 1st Sess. 2, 5, 7, 21 (1979); 125 Cong. Rec. 23791-23793 (1979) (remarks of Rep. St Germain); *id.* at 23797 (remarks of Rep. Wylie)) and "demand deposits" (S. Rep. 96-368, *supra*, at 5, 21).[8] Indeed,

[7] Indeed, the nature of a NOW account makes it unlikely that a depository institution ever would invoke the notice requirement. Withdrawals from NOW accounts typically are made by check to third party payees, and a bank could demand notice only by refusing payment to the payee. Presumably, "[p]ayees would thereafter refuse to accept NOW drafts drawn on that institution" (App., *infra*, 40a n.22). And the unlikelihood that notice ever will be invoked is compounded by the requirement that, when a bank demands notice prior to one depositor's withdrawal of funds from one account, it also must demand notice prior to every depositor's withdrawal of funds from a similar account. 12 C.F.R. 217.5(a).

[8] This has been the consistent congressional view of the nature of NOW accounts since their introduction in the early 1970's. Thus Congress originally was reluctant to authorize use of NOW accounts because it believed that doing so would "infringe[] on a 40-year-old statutory prohibition on the payment of interest on checking accounts" (119 Cong. Rec. 16071 (1973) (remarks of Sen. Brock)). See also *id.* at 15002 (remarks of Rep. Patman) (characterizing NOW accounts as demand accounts); *id.* at 15004 (remarks of Rep. Johnson) (characterizing NOW accounts as checking accounts); *id.* at 16486 (remarks of Sen. Proxmire) (characterizing NOW accounts as demand deposits).

Congress has directed depository institutions to maintain reserves on all of their federally-insured "transaction accounts," thus treating NOW and conventional checking accounts interchangeably. 12 U.S.C. 461(b)(1)(C) and (2)(A).

Given the nature of NOW accounts, allowing the companies controlling nonbank banks to escape regulation under the BHCA inevitably will frustrate the purposes of the statute. The BHCA was enacted "to accomplish two primary objectives": "to prevent the concentration of banking resources in the hands of a few financial giants," and "to implement a congressional policy against control of banking and nonbanking enterprises by a single business entity." *Lewis*, 447 U.S. at 46. See S. Rep. 1095, 84th Cong., 1st Sess. 2 (1955). These policies were forcefully reiterated in 1966, when Congress enacted the demand deposit prong of the BHCA's bank definition. See S. Rep. 1179, *supra*, at 2-3, 7. Yet nonbank banks that offer NOW accounts and make commercial loans are functionally identical to banks. As a result, there is no doubt that the unchecked proliferation of nonbank banks permitted by the Tenth Circuit's interpretation of 12 U.S.C. 1841(c)(1) will permit the unregulated accumulation of banking resources by nonbanking entities, while allowing large institutions to control nationwide banking chains.

The statutory history and purposes outlined above have led one court of appeals to accept the Board's analysis of the BHCA's "legal right to withdraw on demand" language. In *Wilshire Oil Co.* v. *Board of Governors*, 668 F.2d 732 (3d Cir. 1981), cert. denied, 457 U.S. 1132 (1982), a bank attempted to avoid the BHCA's requirements by voluntarily reserving the right to demand 14 days' notice prior to the withdrawal of funds from certain of its accounts, although it informed its customers that it had no intention of exercising that right. 668 F.2d at 734. The Third Circuit upheld the Board's ruling that the institution nevertheless remained a bank, explaining that its holding was supported by the necessity of preventing evasion of the BHCA (*id.* at 738-740) and by its conclusion that an institution offering both checking services and commercial loans "is the type of institution that Congress meant to include within the definition of a 'bank' " (*id.* at 738). It is impossible to square that reasoning with the Tenth Circuit's more formalistic analysis.[9]

b. The court of appeals' analysis of the Board's commercial loan definition also is based on several fundamental misconceptions. At the outset, the court was simply wrong in asserting that in 1970, when the commercial loan element was added to the BHCA's definition of a bank (Pub. L. No. 91-607, § 101(c), 84 Stat. 1762, 12 U.S.C. 1841(c)(2)), both the Board and Congress were aware that the Boston Safe Deposit & Trust Company—a beneficiary of the commer-

[9] The Tenth Circuit attempted to distinguish *Wilshire* by noting that the latter case involved an effort by a bank holding company "to evade the Board's jurisdiction," while the record before the Tenth Circuit in *First Bancorporation* evinced no such intent (728 F.2d at 436). But this distinction is largely imaginary, for there is little doubt that a great many nonbank banks are organized to avoid the BHCA's requirements. The Tenth Circuit also noted that NOW accounts differ from conventional checking accounts in several ways: NOW accounts bear interest and are unavailable to commercial depositors (*ibid.*). But the court of appeals failed to suggest how these distinctions are at all relevant to the legal issue in the case.

cial loan amendment[10]—was engaging in money market transactions. Instead, the Board informed Congress only that "[t]o the best of our knowledge, this amendment would have very limited application at present, possibly affecting only one institution." *One-Bank Holding Company Legislation of 1970: Hearings on S. 1052, S. 1211, S. 1664, et al. Before the Senate Comm. on Banking and Currency*, 91st Cong., 2d Sess. 137 (1970). No reference was made to the activities of that institution, and nothing in the legislative history of the 1970 amendment indicates that either the Board or Congress was familiar with all of the company's operations. See note 10, *supra*.[11]

The 1970 amendment itself contains no definition of "commercial loan." Similarly, the legislative his-

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[10] The commercial loan requirement was added in committee on Senator Brooke's motion (see 116 Cong. Rec. 42426 (1970) (remarks of Sen. Sparkman)). Congress subsequently was informed that "[v]irtually the only bank which does no commercial lending and therefore fits the description is the Boston Safe Deposit & Trust Co., a subsidiary of the Boston Co." (*id.* at 25848) (remarks of Rep. Gonzalez) (reprinting *Financial Report: Banking Lobby Scores in Senate With Second Effort On One-Bank Holding Bill*, National Journal (July 18, 1970)). In 1966, the Boston Company had informed Congress that the Boston Safe Deposit & Trust Company was "primarily engaged in the fields of investment and property management and in the other fiduciary services usually identified with the fiduciary trust business" (*1966 Hearings* at 732). The company therefore asserted that it did "not engage in commercial lending" (*id.* at 733), and on that ground urged that any amendment to the Act be drawn so as to exclude it from coverage. Nothing in the 1970 legislative record—or in the Boston Company's 1966 submission—described the company's money market operations.

[11] It was not until 1972 that a Board ruling revealed that the company was engaging in money market transactions (see App., *infra*, 6a).

tory, which was largely devoted to other matters, contains no description of the nature of a commercial loan. See generally H.R. Rep. 91-1747, 91st Cong., 2d Sess. 23 (1970); S. Rep. 91-1084, 91st Cong., 2d Sess. 24 (1970); 116 Cong. Rec. 42426 (1970) (remarks of Sen. Sparkman). In lieu of such a discussion, Congress simply admonished the Board to "interpret [the] exemption[] as narrowly as possible in order that all bank holding companies which should be covered under the Act in order to protect the public interest will, in fact, be covered." H.R. Rep. 91-1747, *supra*, at 23. At the same time, Congress greatly expanded the scope of the Act by bringing within its provisions previously exempt holding companies, including those that owned only one bank, and by preventing banks from tying the availability of credit to a customer's purchase of goods and services from the bank, its parent, or its sister subsidiaries. See *id.* at 11-12, 28-29; S. Rep. 91-1084, *supra*, at 1-4, 16-17. Congress thus explicitly reaffirmed its strong commitment to the separation of banking and commerce that is central to the BHCA. See H.R. Rep. 91-1747, *supra*, at 11, 21-22; S. Rep. 91-1084, *supra*, at 3. Given this congressional attitude, it was anomalous for the court of appeals to suggest that the 1970 BHCA amendment was intended to exempt a substantial number of commercially-affiliated banking institutions from the Act's prudential restrictions.

Against this background, "the Board has articulated with commendable thoroughness" the reasons for its conclusion that revised Regulation Y's definition of "commercial loan" is necessary to fulfill the statutory mandate. *Securities Industry Ass'n* v. *Board of Governors*, No. 83-614 (June 28, 1984), slip op. 8. The Board has explained that all of the transactions listed in the second prong of revised Regula-

tion Y "establish a debtor-creditor relationship and constitute an extension of credit" (App., *infra*, 46a). Similarly, all of the transactions are "commercial" in nature because all provide funds to commercial enterprises (including banks) "for working capital or current operations" (*id.* at 49a). See *United States* v. *Connecticut National Bank*, 418 U.S. 656, 665 (1974). While several comments on the revisions to Regulation Y expressed the view that the purchase of money market instruments invariably involves passive investing rather than lending (see App., *infra*, 46a, 56a-57a), the Board found that "a substantial portion of the transactions in all of [the listed] instruments occurs through direct negotiation between lenders and borrowers," putting holders of the instruments "in a position to influence the conduct of the borrower" (*id.* at 55a). This state of affairs raises the danger, the Board concluded, that nonbank banks will invest excessively in their affiliates (*id.* at 56a), will improperly tie the availability of credit to the purchase of goods or services from sister subsidiaries (*ibid.*), or otherwise will become affiliated with unduly risky enterprises—results that the BHCA's separation of banking from other forms of commerce was designed to forestall. See S. Rep. 1095, *supra*, at 4-5, 16; S. Rep. 91-1084, *supra*, at 2-4.

Indeed, the Board explained in considerable detail its reason for concluding that *each* of the listed transactions is a commercial loan—reasons that simply were not addressed by the court of appeals. The Board explained, for example, that commercial paper "is a prime quality, short-term unsecured promissory note establishing a debtor-creditor relationship between lender and borrower" (App., *infra*, 49a). This rationale is hardly flawed on its face; last year, this Court noted that "the authority to discount com-

mercial paper" places "banks in their traditional role as a prudent lender," adding that banks acquire commercial paper as part of "the process of extending credit." *Securities Industry Ass'n* v. *Board of Governors*, No. 82-1766 (June 28, 1984), slip op. 20, 21 n.11. Retail installment loans have a similar nature (see App., *infra*, 58a). Broker call loans are demand loans made to securities brokers (see *id.* at 59a). The other transactions listed in revised Regulation Y generally involve the lending of funds by one bank to another (see *id.* at 50a-58a).[12] While it may not be equally obvious that each of these transactions is a loan, the court of appeals plainly erred in upholding a facial challenge to the regulation and thereby invalidating the Board's entire regulatory effort as inconsistent with the statutory language without so much as a reference to the rulemaking record.[13]

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[12] The Board noted that these transactions raise the danger of indirect as well as direct evasion of the BHCA: "The possibility of 'understandings' involving the placing of funds derived from deposit taking by nonbank banks with banking institutions that would agree to take a favorable view toward lending to the nonbank bank's industrial or commercial affiliates would circumvent the purposes of the Act and pose serious enforcement problems" (App., *infra*, 28a).

[13] In reaching its conclusion, the court of appeals placed great weight on what it perceived as a change in the Board's position on the definition of commercial loan. The court noted that, on several occasions since 1970, the Board has allowed institutions that were engaging in money market transactions to escape regulation as banks under the BHCA (App., *infra*, 5a-6a). This recent "complete change" in the Board's position, the court explained, required the application of an unusually strict (although undefined) standard in judging the validity of the Board's action (*id.* at 9a, 15a-16a). Even if we assume that the Board has changed its position "com-

c. Perhaps most fundamentally, the court of appeals' analysis and conclusions were grounded on a basic misconception of the Board's role. The court declined to defer to the Board's expertise for two reasons: because in its view "the BHCA limits the subject matter of the Board's functions basically to anticompetitive considerations" (App., *infra*, 12a), and because the Board's action would lead to "a change in its own jurisdiction" (*id.* at 17a).[14] Both of these lines of analysis are fundamentally flawed.

plete[ly]," however, this approach plainly is incorrect. See *Motor Vehicle Mfrs. Ass'n* v. *State Farm Mutual Insurance Co.*, No. 82-354 (June 24, 1983), slip op. 10-11. To the contrary, this Court repeatedly has "recognize[d] that 'regulatory agencies do not establish rules of conduct to last forever,' *American Trucking Assoc., Inc.* v. *Atchison, T. & S.F.R. Co.*, 387 U.S. 397, 416 (1967), and that an agency must be given ample latitude to 'adapt their rules and policies to the demands of changing circumstances.' *Permian Basin Area Rate Cases*, 390 U.S. 747, 784 (1968)." *Motor Vehicle Mfrs. Ass'n*, slip op. 11. It is true, of course, that when an agency changes its approach it is "obligated to supply a reasoned analysis for the change." *Ibid.* But here the Board has done precisely that, explaining that "conditions have changed so that widespread evasion of the statute has developed through the combination of demand deposit-taking and the placing of the funds thus generated in money market commercial loans" (App., *infra*, 16a).

[14] Although these statements were made during the course of the Tenth Circuit's commercial loan analysis, the court's view of the Board's regulatory role presumably affected its holding on the demand deposit as well as on the commercial loan portion of revised Regulation Y. In any event, the Tenth Circuit's *First Bancorporation* decision—which specifically addressed a Board demand deposit ruling—failed even to suggest that the Board has special expertise in interpreting the BHCA.

In *Board of Governors* v. *First Lincolnwood Corp.*, 439 U.S. 234, 243, 245 (1978), this Court specifically rejected the contention that the Board's statutory role is limited to a consideration of competitive matters. To the contrary, the Court has noted that Congress "committed to the Board the primary responsibility for administering the BHC[A]" (*Securities Industry Ass'n*, No. 83-614, slip op. 8), so that the Board's interpretation of any of the Act's provisions "is entitled to the greatest deference." *Board of Governors* v. *Investment Company Institute*, 450 U.S. 46, 56 (1981) (footnote omitted). Indeed, the Court has suggested that the Board's "'judgment should be conclusive upon any matter which * * * is open to reasonable difference of opinion.'" *Id.* at 56 n.21, quoting *Board of Governors* v. *Agnew*, 329 U.S. 441, 450 (1947) (Rutledge, J., concurring).

The court of appeals' novel proposition that deference is not due the Board when its administrative rulings relate to the scope of its jurisdiction, moreover, is flatly inconsistent with this Court's general teachings on the role of administrative expertise. See *Chevron U.S.A., Inc.* v. *Natural Resources Defense Council, Inc.*, No. 82-1005 (June 25, 1984), slip op. 4-7. Whatever the effect of regulatory action on the administering agency, the administrative views are given special weight because they are grounded on the agency's familiarity with the statutory purpose and the intricacies of the regulatory scheme. See *id.* at 6-7. Thus, deference is particularly appropriate in a case—such as this one—that turns on the meaning of undefined statutory terms. See, *e.g.*, *Unemployment Compensation Comm'n* v. *Aragon*, 329 U.S. 143, 153 (1946); *NLRB* v. *Hearst Publications, Inc.*, 322 U.S. 111, 131 (1944).

Here, Congress has authorized the Board to "issue such regulations and orders as may be necessary to

enable it to administer and carry out the purposes of [the BHCA] and prevent evasions thereof." 12 U.S.C. 1844(b). Given the form of this delegation of authority, "the validity of a regulation promulgated thereunder will be sustained so long as it is 'reasonably related to the purposes of the enabling legislation.'" *Mourning* v. *Family Publications Service, Inc.*, 411 U.S. 356, 369 (1973), quoting *Thorpe* v. *Housing Authority*, 393 U.S. 268, 280-281 (1969). The revised Regulation Y—which manifestly does further the purposes of the BHCA—falls squarely within this principle.

2. By blocking the Board's attempts to stem evasion of the BHCA's requirements through use of the nonbank bank mechanism, the court of appeals' decision will have an immediate and profound effect on the nation's banking system. Almost 170 nonbank banks already have been chartered.[15] If the Tenth Circuit's decision is left intact, there is little doubt that this number will increase at an accelerating rate: more than 200 additional applications are pending before the Board or the Comptroller of the Currency, and there is no reason to believe that this tide will abate in the absence of Board regulation. Cf. App., *infra*, 24a-25a. In addition, almost 100 industrial banks—which in recent years have begun offering NOW accounts and making commercial loans (see *id.* at 24a, 42a), and thus functioning like commercial banks—now offer services that place them within the ranks of nonbank banks, and many more may soon follow suit. See *Competitive Equity in the Financial Services Industry: Hearings Before the Senate*

[15] The figures involving the numbers of chartered and operating nonbank banks have been provided by the Board; they take account of applications submitted to and acted upon by the Comptroller of the Currency.

Comm. on Banking, Housing, and Urban Affairs, 98th Cong., 2d Sess. 1638, 1644 (1984).

This creation of a large and growing class of banking institutions that are not regulated under the BHCA will change the face of banking in the United States. The majority of nonbank institutions are part of interstate enterprises, meaning that the nonbank phenomenon for the first time permits the largely unrestricted growth of interstate banking networks. This development, the Board found (App., *infra*, 28a), will lead to increased concentration of banking resources, while distorting the balance between state and federal bank regulation struck by Congress in 12 U.S.C. 1842(d)—a consideration that has led at least nine states to protest the establishment of nonbank banks within their boundaries.[16]

Similarly, approximately 60 nonbank banks now are owned by institutions other than traditional bank holding companies, including insurance, commercial, securities and industrial firms (App., *infra*, 24a n.7).[17] Such companies also have approximately 40

[16] Within the last year, three states—Colorado (Colo. Senate Bill 47 (Jan. 30, 1985)), Florida (Fla. Stat. Ann. § 658.29(1) (West 1984)), and North Carolina (N.C. Gen. Stat. § 53-229 (1984))—have enacted legislation prohibiting out-of-state bank holding companies from acquiring nonbank banks in those states. Banking officials in Ohio, Tennessee and New Jersey have urged the Board not to approve the formation of nonbank banks within their borders (see App., *infra*, 62a-71a), while officials in three other states (Texas, Iowa and North Dakota) have announced their opposition to the creation of nonbank banks. See *Texas Warns It Will Sue to Keep Nonbank Banks Out of the State*, American Banker, Nov. 8, 1984, at 2.

[17] These include institutions such as Sears, Roebuck & Co.; J.C. Penney & Co., Inc.; Shearson/American Express, Inc.; Dreyfus Corp.; Merrill Lynch & Co., Inc.; Prudential-Bache

applications for nonbank banks pending. The continuation of this trend will to a large degree obviate the BHCA's time-honored dichotomy between banking and commerce, while placing traditional bank holding companies—which continue to be regulated by the BHCA—at a severe competitive disadvantage. See App., *infra*, 27a.

These far-reaching consequences of the court of appeals' decision—which will have a nationwide impact—indicate that review of the nonbank bank issue by this Court is warranted at this time. Unless the status of the nonbank bank is resolved soon, the rapid proliferation of such institutions will settle the issue by default: even if the Board's position were to prevail at some time in the indefinite future, dismantling the vast numbers of new nonbank banks would present severe practical problems, while permitting those institutions to continue in operation would introduce substantial competitive inequities into the banking system.[18]

Securities, Inc. and similar entities. See American Banker, Oct. 31, 1984, at 16-17.

[18] The nonbank issue also has attracted considerable legislative interest. The BHCA's definition of a bank was last modified in 1982 (see Garn-St Germain Depository Institutions Act of 1982, Pub. L. No. 97-320, § 333, 96 Stat. 1504, 12 U.S.C. 1841(c)), when federally-insured savings and loan institutions were excluded. In the last session of Congress the Administration and the Board joined in supporting an omnibus banking bill that, among other things, would have closed the nonbank loophole by defining as a bank within the meaning of the BHCA all federally-insured banks. That bill (S. 2851) passed the Senate by a vote of 88-5, but was not acted on by the House. It is anticipated that the Administration and the Board will renew their legislative efforts during the current session of Congress; three bills have been introduced in the current session that address the nonbank loophole.

CONCLUSION

The petition for a writ of certiorari should be granted.

Respectfully submitted.

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I authorize the filing of this Petition.

LAWRENCE G. WALLACE
Acting Solicitor General *

FEBRUARY 1985

See H.R. 15, 99th Cong., 1st Sess. (1985); H.R. 20, 99th Cong., 1st Sess. (1985); H.R. 428, 99th Cong., 1st Sess. (1985). There is no assurance that legislation will in fact be forthcoming, however, and when adopting revised Regulation Y the Board concluded that in the absence of regulatory action the proliferation of nonbank banks would "preempt Congressional discretion to determine the proper delineation between banking and commerce" (App., *infra*, 22a). We will, of course, keep the Court advised of significant legislative developments in this area.

* The Solicitor General is disqualified in this case.

APPENDIX A

UNITED STATES COURT OF APPEALS
TENTH CIRCUIT

83-2696, 84-1011, 84-1122,
84-1257, 84-1270, 84-1407

DIMENSION FINANCIAL CORPORATION, DANIEL T. CARROLL, HAROLD D. DUFEK, WILLIAM L. MITCHELL, RONALD L. SHAFFER, A. GARY SHILLING, STATE OF OHIO, OHIO DIVISION OF SAVINGS AND LOAN ASSOCIATIONS, OHIO DEPOSIT GUARANTEE FUND, HORIZON SAVINGS AND LOAN COMPANY, HORIZON SERVICE CORPORATION, PERMANENT SAVINGS AND LOAN ASSOCIATION, FINANCIAL INSTITUTIONS ASSURANCE CORPORATION, FIRST BANCORPORATION, COLORADO INDUSTRIAL BANKERS ASSOCIATION, FORT LUPTON INDUSTRIAL BANK, MONROE INDUSTRIAL BANK, CASTLE ROCK INDUSTRIAL BANK, ARK VALLEY INDUSTRIAL BANK, HOUSEHOLD WELD COUNTY INDUSTRIAL BANK, HOUSEHOLD LAMAR INDUSTRIAL BANK, HOUSEHOLD ALAMOSA INDUSTRIAL BANK, HOUSEHOLD VALLEY INDUSTRIAL BANK, HOUSEHOLD SALIDA INDUSTRIAL BANK, COPPER STATE THRIFT & LOAN COMPANY, and COPPER STATE FINANCIAL CORPORATION, PETITIONERS

v.

BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM, RESPONDENT

AMERICAN FINANCIAL SERVICES ASSOCIATION and HOUSEHOLD FINANCE CORPORATION, INTERVENORS

On Petition For Review Of A Regulation Of The Board of Governors Of The Federal Reserve System

[Filed Sept. 24, 1984]

Before SETH, DOYLE and SEYMOUR, Circuit Judges.

SETH.

This is a Petition for Review of changes made by the Board of Governors of the Federal Reserve System in Regulation Y (12 C.F.R. Part 225-1983) as it defines which financial institutions are "banks" and thus come under the Bank Holding Company Act (12 U.S.C. §§ 1841-50). The acquisition of a "bank" requires prior approval by the Board of Governors and the company which acquires a "bank" becomes a "bank holding company" subject to the Act. A "bank holding company" is a company which has control over any "bank." 12 U.S.C. §1841(a)(1). What was a "bank" in the original Act depended on its charter. Since the enactment of the Holding Company Act the definition of a "bank" has been narrowed by several statutory changes.

In 1966 the charter test was abandoned and a "bank" was defined as an institution which accepted deposits which "the depositor has a legal right to withdraw on demand." The Board agreed with the change. Then in 1970 the BHC was amended further to provide that a "bank" was an institution which accepted deposits "which the depositor has a legal

right to withdraw on demand" (as before), but added "and engages in the business of making commercial loans." (12 U.S.C. § 1841(c)) The definition was thus narrowed to require that both the deposit and commercial elements must be present to constitute a "bank." It is pursuant to this statutory provision or definitions that the Board argues it proceeded in its changes of Regulation Y with which we are here concerned. The Board's changes redefined the demand and the commercial loan components of the statutory provisions. The statute states what sort of demand deposits are to be used but as to loans only says "engages in the business of making commercial loans."

The new and challenged Regulation Y defines "commercial loans" in 12 C.F.R. part 225, § 225.2:

> "(B) 'commercial loans' means any loan other than a loan to an individual for personal, family, household, or charitable purposes, and includes the purchase of retail installment loans or commercial paper, certificates of deposit, bankers' acceptances, and similar money market instruments, the extension of broker call loans, the sale of federal funds, and the deposit of interest-bearing funds."

The challenge by petitioner goes to the inclusion of the "other than" transactions as commercial loans.

The purpose of the Bank Holding Company Act, as amended, is stated in S. Rep. No. 1084, 91st Cong., 2d Sess., *reprinted in* [1970] U.S. Code Cong. & Ad. News 5519, 5541.

This review concerns, with the changes in Regulation Y, both the demand deposit element of the definition in the new Regulation Y and the definition of "commercial loans" therein.

We have considered in First Bancorporation v. Board of Governors, 728 F.2d 434 (10th Cir.), the demand deposit aspect in the context of an order directed to one or two institutions and also generally. There would seem to be no need to repeat or add to what was there said and we adhere to that opinion.

The matter of the Board's new and changed view as to what constitutes a "commercial loan" under the 1970 Amendment (the Act) requires some further consideration.

I. "Commercial Loans"

The definition of "commercial loans" since 1970 was developed by regulatory agencies in determinations that particular transactions were *not* commercial loans under the Act. These exclusions have been explained by comparisons with the attributes of transactions generally accepted in the business as commercial loans. The rationalizations are not as important for our purposes as are the conclusions which were reached. This appeal in large part is concerned with money market and interbank transactions which heretofore were not considered to be commercial loans and which are defined as such by changes in Regulation Y.

There is no serious dispute that the term "commercial loan" was in common use and had a generally accepted meaning in 1970 both in the business and by all regulatory authorities, including the Board. There has been no change of this meaning in the business since that time, none evidenced by Congress, and no change by the regulatory agencies except the Board. The Board is thus alone in its new position and this is understandable because it was adopted with no reference to the actual meaning, but instead was

adopted purely to carry out a new Board policy—to *stop changes* in the business of providing financial services—thus to bring a large number of additional enterprises under its jurisdiction by a change in definitions and so as to accomplish this halt to change. In short, the new definition had nothing to do with the original meaning of the term nor the then current meaning, but instead was a device to accomplish an end—a change in the Board's jurisdiction. It was a device to freeze the changes in the business of financial services until the Board could persuade Congress to act. Congress had theretofore declined to adopt a moratorium proposed by the Board on changes which would also have used new definitions to accomplish the purpose. However, as a practical matter, with the new definitions there was more than a halt. It was to cause pervasive changes, thus to cause existing businesses to suddenly become bank holding companies and to necessitate reversal of acquisitions and to bring about divestitures; to change the investments permitted of state chartered savings and loans; and to have other consequences on existing business. It affected other regulatory agencies. For example, the changes required federal deposit insurance for entities which had insurance under state funds and other funds. It required entities to obtain such insurance which were not eligible for it. In short, the changes in definitions and the jurisdiction of the Board would cause extensive changes by other agencies and of course by some entities providing financial services to the public.

II. The Board since 1970 has taken a position on the relation of the Bank Holding Company Act to institutions engaging in all significant money market and interbank transactions. In each instance before

1982 the opinion or advice or ruling was that the transaction was not a commercial loan under the Act. Thus in a 1972 letter to the Federal Reserve Bank of Boston the Board, in reference to the Boston Safe Deposit Company, stated the sale of federal funds was not a commercial loan under the Act nor was the purchase of bankers' acceptances, certificates of deposit, or commercial paper. In 1976 the Board ruled that broker call loans were a passive medium of investment with no close lender-borrower relationship as existed with commercial loans under the Act. In 1980 the Board's Legal Division in a letter to the Federal Reserve Bank of Boston stated that the purchase on the secondary market of the guaranteed segment of SBH and Farmer's Home loans was not commercial lending.

In 1981 an internal memorandum (February 10, 1981) stated that the purchase of money market funds including certificates of deposit, bankers' acceptances and commercial paper were not commercial loans, nor were the purchases of federal funds nor were brokers' call loans commercial loans under the Act.

Later in 1981 the Board again evidenced the existence of its position expressed in the instances referred to above. In this transaction Associates First Capital Corporation purchased the Fidelity National Bank of Concord, California. Associates Corporation was owned by Gulf & Western, a nonbank corporation. The bank divested itself of its commercial loans. However, it remained in the money market and engaged in interbank transactions and the Board was of the view that these did not constitute commercial loans and Fidelity was not a "bank" under the Act.

What may fairly be described as the consistent policy or position of the Board described briefly above

came to an end in December 1982. The Dreyfus Corporation considered the purchase of a nonmember state bank (Lincoln) insured by the FDIC. The proposal was to have the bank cease making commercial loans and to have it divest itself of such existing loans. The Board responded that Lincoln would nevertheless be a "bank" under the Act because in the Act the term "commercial loans" included the purchase of

> "commercial paper, bankers acceptances, and certificates of deposit, the extension of broker call loans, the sale of federal funds, the deposit of interest bearing funds and similar lending vehicles."

In Dreyfus the FDIC disagreed with the new position of the Board and permitted the acquisition of Lincoln under the conditions described. The FDIC in a letter of December 29, 1982 from the Deputy Chairman commented that the Board had "dramatically recast the definition of commercial loan," and the FDIC "was constrained to follow the clear legal precedents established over the years," and further commented that a change as expressed by the Board should be brought to the attention of Congress and not handled by agency action.

Also in Dreyfus the Comptroller as to a separate charter application stated "that the inclusion of money market transactions within the BHCA term 'commercial loans' is not supported by the purpose or the legislative history of the BHCA," and referred to the Boston Safe matter. The Comptroller described as the money market transactions referred to were essentially a passive medium of investment and involved no close lender-borrower relationship and thus

did not constitute a threat of the abuse sought to be met by the Act.

The Board Dreyfus letter (December 1982) was followed in May of 1983 by the Board's notice of the proposed changes in Regulation Y here considered. The changes by Regulation Y must be characterized as a complete "reversal" of the Board's previous position. The change was from white to black, from no to yes. It was not a modification or variation on the previous position nor did it seek to fill in some sort of gap. Money market transactions on one day were not commercial loans and the next day they were. This in itself does not sound so drastic, but the consequences sought to be visited thereby on a variety of financial institutions and their long-standing relationships and the regulatory authorities were indeed drastic. No party contends that the new definition is in accord with common usage.

III. The purpose of the reversal of position by the Board was, as already described, to stop the changes which were proceeding at a fast pace in businesses providing financial services. In order for the reversal to be effective the Board's authority had to be and was expanded to include institutions not theretofore within its jurisdiction as to all, or as to substantial parts of their activities. As also mentioned, this expansion of jurisdiction was very much more than just the prevention of future acquisitions, arrangements or affiliations. It was to cause divestitures of old acquisitions, sale of assets, changes in permitted uses of excess funds by state chartered and other institutions. It also was to have a drastic impact on many other types of business arrangements and on the way business was conducted, who could insure deposits and changes in regulatory authority from states to the "feds."

Such a complete change and one which is a redefinition and expansion of jurisdiction by an agency requires that different standards be met than are demanded in a typical administrative redefinition not involving such elements.

One additional factor present here is the reason why the change was made. The departure from the accepted meaning or general usage prevailing at the time Congress passed the Act was not a consequence of any original error; nor of any change in trade usage; nor as a result of any signal from Congress; nor to coincide with the views of other regulatory agencies. Instead the change was to provide, by an expansion of jurisdiction, a regulatory device to change the course of the development of financial institutions which had taken place in conformance with the Act as construed by the Board from the outset. The Board since 1970 thus gave strong signals as to the definitions which created exceptions to the Act. The Gulf & Western decision was one of several such signals.

The new kinds of institutions which grew in number under the statutory-administrative provisions were well within the permitted exceptions, some formally approved, and cannot be considered as departures nor as evasions of the Act. A permitted exception cannot now be classified as an evasion as the Board would argue.

IV. The Act itself with the clearly expressed definitions permitted the development of the non-bank banks. The exceptions created by the definitions were based on industry usage, as mentioned, and contemplated that *some* institutions would not be included. An example is Boston Safe which was brought to the attention of the Senate by Mr. Robertson, head of the

Board. The Board obviously knew what Boston Safe was doing. The statute thus anticipated exceptions, but apparently no one anticipated that the pressure for change in financial services would be as great and the business so volatile as it was in the years following. The problem has come not from the scope of the intended exceptions nor from the validity of the definitions, but from the prediction as to the numbers or volume within the exceptions. A prediction which probably no one could have accurately made, and the resulting problem, if it is that, could have been (or could be) resolved only by Congress should it perceive a need to act as in 1956, 1966 and 1970.

The changes which have come about cannot be characterized as "evasions" of the Act. The entities have followed the Act, and have followed the interpretation by the agency. There is nothing before us to indicate any violations of the regulations, and the Board has pointed out none. Early on in Boston Safe a strong signal was given as to what was permissible, and as late as Gulf & Western the Board demonstrated what still could be done. It is difficult to understand how the latter could be characterized as an "evasion."

V. Legislative History

The legislative history of the 1970 Amendment contains an unusual and significant element. This is again the Boston Safe Deposit & Trust Co. application which was apparently pending at the time the Senate was considering the 1970 Amendment (the Act). To repeat, Mr. Robertson of the Board then advised the Senate committee that the 1970 Amendment would have a limited impact and this would

"include" the Boston Safe Deposit & Trust Co. This "impact" was the fact that Boston Safe would not be a "bank" as it would be excluded by the term "commercial loans" in the Act. The Board, of course, knew of the transactions Boston Safe sought to engage in (or was then engaging in), and these were demand deposits and the typical money market and interbank transactions. It apparently also assumed that the Senate committee also knew. These as described above were then not considered in the business as "commercial loans." The Board stated that it did not consider them as included in the term "commercial loans" and so advised the Senate committee. To repeat, the Board was of the view that Boston Safe was not a bank.

It seems to have been agreed that the 1966 definition of a "bank" was too broad and to narrow the exceptions some reference to loans should be made. In S. Rep. No. 1084, 91st Cong., 2d Sess., *reprinted in* [1970] U.S. Code Cong. & Ad. News 5519, 5541, the Senate committee indicated that the then existing definition was intended "to include commercial banks and exclude those institutions not engaged in commercial banking" as the Bank Holding Company Act was designed to prevent the misuse of commercial bank credit and the concentration of control over commercial banks. The Board then agreed that the 1966 definition might include institutions which were not in the commercial banking business—that is did not make commercial loans. The 1970 Amendment thus excluded financial businesses which did not make such loans.

There can really be no serious dispute but that the term "commercial loans" as used in the banking business when the Act was adopted did not include the

purchase of money market transactions nor certificates of deposit nor did it include interbank transactions.

The position taken by several of the Federal Reserve Banks and by the FDIC and the Comptroller contrary to that of the Board, and the reasons such regulatory agencies have expressed, demonstrate the accepted meaning then and now of the term "commercial loans."

The purchases added by the Board are for the most part open market transactions—purchases on a secondary market—where prices are set not by the parties but by all market transactions. The Board has shown no facts which would show abuses contemplated by the BHCA in commercial banking by those engaging in money market transactions.

VI. The Board under the BHC Act has authority to make rules and regulations. Under Section 5(b) of the Act (12 U.S.C. § 1844(b)) the Board is authorized to issue orders and regulations "as may be necessary to enable it to administer and carry out the purposes of this chapter and to prevent evasions thereof."

The authority of the Board under the Act is to be exercised in a restricted area. It does not have the broad scope to work in as do many other agencies. There is not present a "public good" or "public benefit" provision. Instead, the BHCA limits the subject matter of the Board's functions basically to anticompetitive considerations.

This matter was discussed by this court in Western Bancshares, Inc. v. Board, 480 F.2d 749 (10th Cir.), where the Board had disapproved an acquisition because the same price was not paid for all shares. We there referred to the "express factors" in the Act:

"Rather, the thrust of the 1970 amendments is designed to more adequately protect against abuses which may be of future concern on the part of previously exempt one-bank holding companies in addition to certain modifications relating to companies controlling more than one bank. These possible abuses or future concerns related to monopolistic practices, lessening of competition and extension of a line of credit to finance an unrelated business concern over which it had control. By bringing the one-bank parent holding company within the Act, Congress expressed concern only that the Board be allowed to exercise control relating to the express factors above referred to and management policies of the bank in meeting the public need and convenience.

. . . .

". . . The selective process of the Board in relying upon the broad maxim or reference to the 'public interest' lends no aid, and in fact blends with confusion in the decisional process here involved. Congress *did not* isolate the terms to fit the Board's fancy. It spelled out the specific factors to be considered by the Board relating thereto. . . . We are not dealing in the broad spectrum of administrative policy delegated by Congress to an agency determinative of 'public interest, convenience, and necessity.' Public Utilities Commission of the District of Columbia v. Pollak, 343 U.S. 451, 72 S.Ct. 813, 96 L.Ed. 1068 (1952). Issues as to the reasonableness or inequality of stock purchases must be decided upon the basis of the law of contracts, or such other principles of law as may be applied in a forum competent to adjudicate the issue between

the parties thereto. Contemporaneous construction of a statute by an agency charged with its enforcement is entitled to great deference by the courts. Griggs v. Duke Power Co., 401 U.S. 424, 91 S.Ct. 849, 28 L.Ed.2d 158 (1971). But we are not bound thereby, and particularly so where neither the Act nor the legislative history contains one word expressly permitting the administrative authority assumed." (Emphasis in original.)

The court in Patagonia Corporation v. Board, 517 F.2d 803 (9th Cir.), considered a prior position taken by the Board on other applications, and said:

> "These inconsistent prior adjudications, which are among the very few previous examples of the Board's prior consideration of the controlling influence tests, indicate that the position that the Board advances with respect to Patagonia is not the type of consistent, clearly articulated administrative interpretation of a statute with which the courts are generally reluctant to interfere."

Also of significance the court in *Patagonia* also considered the narrow scope of the Board's function and of this said:

> "It is of interest to note that under the Act, the Board's administrative mandate is not open ended. Congress did not write the Act in general terms, thus leaving extensive areas of law to be developed by the Board. Rather, the Board is charged with responsibility for administering relatively specific statutory provisions. See Western Bancshares, Inc. v. Board of Governors, 480 F.2d 749, 753-54 (10th Cir. 1973); 15 B.C. Ind. & Com.L.Rev. 369 (1973). Congress surely did not intend that the Board would be empowered to expand or constrict the statutory definition of 'subsidiary' or the grandfather proviso, the scope of which Congress carefully considered, in accordance with the Board's conception of regulatory needs. That the Board's mandate under the Act is relatively circumscribed is also relevant in determining the extent to which courts must defer to the Board's interpretation of the Act."

In Garvey v. Freeman, 397 F.2d 600 (10th Cir.), this court considered administrative interpretations and we there quoted from Stark v. Wickard, 321 U.S. 288, 309-310, as follows:

> " 'When Congress passes an Act empowering administrative agencies to carry on governmental activities, the power of those agencies is circumscribed by the authority granted. * * * The responsibility of determining the limits of statutory grants of authority in such instances is a judicial function entrusted to the courts by Congress by the statutes establishing courts and marking their jurisdiction.' "

The Supreme Court in Board of Governors v. First Lincolnwood Corp., 439 U.S. 234, in the application of a financial soundness test found specific statutory authority for the Board's act. The Third Circuit in Wilshire Oil Co. v. Board of Governors, 668 F.2d 732, considered an obvious attempt, by changes in terms of demand deposits, to evade the Act's definition of deposits. This represents a significant decision on evasions of specific provisions of the Act.

There is a related doctrine which must be considered when an agency radically changes its position

on statutory construction. In such circumstances the agency must clearly articulate the basis for the change. This is not only an aspect of any procedural notice requirement in rulemaking but is a substantive need. The Supreme Court in Motor Vehicle Manufacturers v. State Farm, —— U.S. ——, 103 S.Ct. 2856, 51 U.S.L.W. 4953, mentions this requirement. The articulated facts must show a purpose for the change well within the agency authority.

It is, of course, necessary that the regulatory authorities be able to change to meet new conditions arising within their sphere of authority *and* for a purpose or to accomplish a result within their authority. The Court in American Trucking, Inc. v. AT&SF R. Co., 387 U.S. 397, very clearly enunciated this proposition.

VII. The doctrine which accords deference to regulatory agencies in their implementation of statutory provisions has been thoroughly developed and needs no discussion here. This court has recognized it as quoted herein and we do so now. The application of the doctrine assumes that the regulatory authority is acting on a matter within the subject matter scope of its statutory duties. It also assumes that the action has been taken to carry out the particular purpose of the statute and not to meet other conditions, related or not, that the agency decides should be changed or regulated. Instead, such action requires a change in the jurisdiction of the agency by Congress.

It must be recognized that the statute here concerned is of very narrow scope and the Board necessarily operates within these limitations. Likewise the statute has a clearly recognized purpose and again the actions of the Board are confined to the accomplishment of this purpose. "Expertise" in this context can only mean the skill and experience of the agency within its proper scope of activity.

We cannot hold that the limited authority of the Board permits it to itself bring about the change here attempted and a change in its own jurisdiction no matter how necessary it perceives the change to be, and no matter how serious it may consider the inaction of Congress to be in the face of the growth of financial institutions presently outside the Board's statutory jurisdiction.

We are concerned about the positions contrary to that taken by the Board expressed by the Comptroller of the Currency and the Federal Deposit Insurance Corporation which are regulatory agencies in the same field and with some overlapping functions. We also note the contrary views of several regional Federal Reserve Banks. The Federal Reserve Bank of Atlanta stated as to changes in the Board's position, "Since the new definition of commercial loans has no basis in tradition or in the BHC Act it appears to provide an overly broad extension of the regulation." The Federal Reserve Bank of San Francisco stated it was "not convinced that the Board's expansive reading of 'bank' is justified, or that Congress intended that so-called 'nonbank banks' be subject to Board authority under the Bank Holding Company Act." The Federal Reserve Bank of Chicago expressed a similar view.

VIII. It does not appear necessary to discuss how the assertion of authority to control the use of excess or investment funds will affect state institutions. We do not comment on the distinctions made between NOW acounts and demand deposits in the Garn-St. Germain Act (Pub. L. No. 97-320), nor do we feel it necessary to discuss the Douglas Amendment although

it is a significant factor in the mix of state and federal regulation.

The possible exception to the initial impact of Regulation Y (Part 225.21(B)(4)) contains requirements with no objective standard and completely with agency discretion. This as a device to meet objections to the new regulation cannot cure the exercise of powers denied by Congress or not provided for by Congress. Public Utilities Comm. of Calif. v. United States, 355 U.S. 534; In re Surface Mining Regulation Litigation, 627 F.2d 1346 (D.C. Cir.).

The Act expressly requires the Board to annually make recommendations to Congress as to changes in the law which it feels desirable. 12 U.S.C. § 1844(d).

We have carefully considered the Appendix which accompanied the changed Regulation Y when it was issued. It contains the Board's view of the need for changes and states the Boards' conclusions as to several conditions it perceived to exist.

The petitioner asserts that facts were not presented in advance of the adoption of the changes to an extent that any meaningful comments could be made as required by the APA. *See* Texaco, Inc. v. F.P.C., 412 F.2d 740 (3d Cir.), and thus faults the adoption of the changes. We, however, express no opinion on this point.

As mentioned at the outset, there would seem to be no need to again cover the demand deposit element in the changes. We decided this matter in First Bancorporation v. Board of Governors, 728 F.2d 434 (10th Cir.). We abide by that decision which is fully applicable to the same issue now before us again.

The order and rule of the Board adopted on December 29, 1983 which amended the then existing Regula-

tion Y (12 C.F.R. Part 225-1983) are hereby set aside. IT IS SO ORDERED.

IT IS FURTHER ORDERED that the Board shall not attempt to enforce or implement such changes herein held invalid. The mandate shall issue in the usual manner.

APPENDIX B

SUPPLEMENTARY INFORMATION, APPENDIX A

[49 Fed. Reg. 833-842 (1984)]

The proposed revision of Regulation Y included the following definition of "bank":

> any institution organized under the laws of the United States that accepts demand deposits and engages in the business of making commercial loans.

This definition essentially reiterates the two-pronged definition of bank in section 2(c) of the BHC Act, which defines a "bank" as "any organization . . . which (1) accepts deposits that the depositor has a legal right to withdraw on demand, and (2) engages in the business of making commercial loans." [1] The bank definition is the key to the Act because it supplies the basis for effecting the fundamental purposes for which the legislation was enacted: (1) the separation of the business of banking from commerce to assure impartiality in the granting of credit and avoidance of conflicts of interest; (2) the limitation of risk to the banking system inherent in the unlimited association of banking and commerce; and (3) the prevention of concentration of banking resources.

In order to clarify the coverage of the bank definition consistent with these policies, the Board has in-

[1] 12 U.S.C. § 1841(c). There are a number of statutory exemptions to this definition, *e.g.*, for FSLIC insured thrift institutions.

terpreted the terms "deposits that the depositor has a legal right to withdraw on demand" [2] and "commercial loans" in section 2(c) of the Act. In approving an application by a bank holding company under the Act to acquire an industrial loan company that offered NOW accounts and made commercial loans, the Board interpreted the phrase "deposits that the depositor has a legal right to withdraw on demand" in section 2(c) of the Act to include NOW accounts. *First Bancorporation* (*Beehive Thrift and Loan*), 68 Federal Reserve Bulletin 253 (1982).

Similarly, in reviewing a proposal to acquire an FDIC insured state bank by The Dreyfus Corporation, a nonbanking organization engaged in the underwriting and sale of securities, the Board reiterated its view that the term commercial loan in section 2(c) of the Act means any loan the proceeds of which are used for other than personal, family, household, or charitable purposes. The Board also determined that, for this purpose, commercial loans include the purchase of commercial paper, bankers acceptances, and certificates of deposit, and the sale of federal funds and other transactions that establish a debtor-creditor relationship. Letter of December 10, 1982, to the FDIC.

The proposed amendments would incorporate the Board's interpretations into Regulation Y. A number of commenters opposed the definitions. The Independent Bankers Association favored the definitions, and the American Bankers Association supported the proposed definition of "commercial loan."

After careful consideration of the comments, the Board has determined to adopt the "bank" definition

[2] Hereinafter "demand deposit."

with minor modifications, including its interpretations of the terms demand deposit and commercial loan. The Board believes that these interpretations are both necessary and appropriate to carry out the fundamental purposes of the Act. In the Board's judgment, any other interpretation of these important terms would produce a result that is plainly at variance with the purposes of the Act and would preempt Congressional discretion to determine the proper delineation between banking and commerce in this country as well as the scope for interstate banking. The Board's interpretation of the bank definition is directed towards this end, consistent with its authority under section 5(b) of the Act to issue rules and regulations.

As originally enacted, the BHC Act defined "bank" as "any national banking associataion, or any State bank, savings bank, or trust company. . . ." In 1966, Congress eliminated this charter test in favor of the functional demand deposit test. The legislative history of these amendments indicates that Congress intended to cover all checking accounts as demand deposits and did not intend to exempt from the definition of "bank" institutions that function like banks. Congress viewed the ability to offer checking accounts as critical in determining whether an institution meets the "demand deposit" portion of the Act's definition of bank and intended demand deposits to include all checking accounts.

In 1970, Congress again amended the Act by adding a second requirement for bank status: that the institution also be engaged in the business of making commercial loans. The Board did not propose the amendment in 1970, which limited the definition of bank to those institutions that accept demand de-

posits and make "commercial loans," although the Board offered no objection to the amendment because it was intended to be narrow in scope, possibly exempting only a single company—Boston Safe Deposit and Trust.[3] The Board's view is reflected in a letter from Federal Reserve Board Chairman Burns to Chairman Sparkman of the Senate Banking and Currency Committee:

> ". . . S. 3823 would amend the definition of "bank" to exclude banks that make no commercial loans. To the best of our knowledge, this amendment would have very limited application at present, possibly affecting only one institution. Since there is less need for concern about preferential treatment in extending credit where no commercial loans are involved, and in view of the very limited application of this amendment, the Board would have no objection to its adoption.[4]

The House conferees agreed to the change of the definition of "bank" (not present in the House passed bill), but the majority of the House conferees cautioned that the Board should construe the 1970 exemptions from the Act "as narrowly as possible in order that all bank holding companies which should

[3] 116 Congressional Record S. 6908, 6911 (daily ed. May 11, 1970); 116 Congressional Record H. 7207 (daily ed. July 27, 1970); 116 Congressional Record S. 20642 (daily ed. December 18, 1970).

[4] One Bank Holding Company Legislation of 1970: Hearings on S.1052, S.1664, S.3823; and H.R. 6778, Before the Senate Committee on Banking & Currency, 91st Cong., 2d Sess. 137 (1970).

be covered under the Act in order to protect the public interest, will, in fact, be covered." [5]

These modifications to the definition of bank in the Act were designed to exclude from coverage under the Act savings banks, trust companies and industrial banks.[6] In both 1966 and 1970, savings banks, trust companies and industrial banks bore little resemblance to commercial banks because these three types of entities did not have bank charters or their activities were confined to fiduciary activities, the taking of savings and time deposits, and the making of home mortgages and consumer loans.

Between 1970 and 1981, the exemption remained within the narrow confines intended by Congress. However, since 1980, the powers of industrial banks have substantially expanded and they are eligible for FDIC insurance, making them for all intents and purposes banks. More importantly, a large number of insurance, securities, industrial and commercial organizations have acquired FDIC insured national or state banks.[7] These acquisitions have been accomplished through the device of divesting a portion of the acquired bank's commercial loan portfolio and continuing to accept demand deposits or through giving up the taking of demand deposits but continuing to make commercial loans. Both techniques are premised on a narrow interpretation of the terms

[5] Statement of the Managers on the Part of the House, H. Rep. No. 1747, 91st Congress, 2d Sess. 23 (1970).

[6] S. Rep. No. 1179, 89th Cong., 2d Sess. 7 (1966); S. Rep. No. 91-1084, 91st Cong., 2d Sess. 24 (1970).

[7] Since 1980, there have been a number of acquisitions of insured banks by insurance, securities, commercial and industrial companies.

demand deposits and commercial loans in section 2(c) of the Bank Holding Company Act.

These so-called "nonbank banks" acquired through this device continue to take deposits from the public, to make loans, to enjoy the benefits of discount window access and federal deposit insurance, and to have access to the payments system. They remain for all practical purposes banks, but are not subject to the prudential limitations that Congress deemed essential when banks are affiliated with commercial enterprises. Indeed, the charter powers of a "nonbank bank" are identical to those of a full service commercial bank—and it is only different to the extent that the nonbank bank *voluntarily* chooses not to offer commercial loans or demand deposits under a narrow definition of those terms.

Acquisitions of this nature and in the numbers that have occurred were not contemplated by the 1970 Amendments. As noted above, the Board advised Congress that it believed the exemption would be of "very limited application," and the House Conferees admonished the Board to construe the exemption "narrowly." Such a construction is consistent with the broad expansion of the Act's coverage accomplished by the 1970 Amendments to encompass partnerships, one bank holding companies, and control relationships based on a controlling influence. Indeed, the desire to prevent evasion of the Act's purposes in 1970 was sufficiently pervasive for Congress to reject a proposed exemption for very small banks which had no more than $3 million in net worth.[8] It is inconsistent with the Congressional intent as expressed in the Act to suggest that at the same time Congress substan-

[8] Statement of The Managers on the Part of the House, *supra* at 23.

tially expanded the Act's coverage to ensure the separation of banking and commerce, it took the significant step, almost without debate, of creating a new class of depository institution that could be acquired by all types of nonbanking organizations.

The primary impetus for the 1970 Amendments were two events that occurred in the late 1960s. First, the largest banks in the nation sought to use the then existing one bank holding company exemption to form holding companies and commence various nonbanking activities, at times through the acquisition of going concerns such as large insurance companies. At the same time, large nonbanking organizations such as manufacturing firms, insurance companies, and retailers began to acquire single banks. Congress sought to block both of these trends through the 1970 Amendments.[9] The recent acquisition of banks by large commercial enterprises such as insurance, securities, and industrial companies is completely inconsistent with expressed Congressional intention to prevent such affiliations.[10]

In recognition of the unique and critical role that banks play in the nation's financial system and economy with respect to operation of the payments system, as custodians of the bulk of liquid savings, and as suppliers of credit, Congress has provided these institutions with access to the Federal Reserve as a

[9] Statement of the Managers on the Part of the House, *supra*, at 11; S. Rep. No. 1084, *supra*, at 2-3; Cong. Rec. S 1696 (1969) (Remarks of Sen. Proxmire); Cong. Rec. H 9776-77 (1969) (Remarks of Cong. Patman).

[10] Moreover, many of the "nonbank banks" that nonbanking companies have formed differ significantly from the institution for which the exemption was written, since Boston Safe was primarily engaged in trust company business in 1970.

lender of last resort, and access to federal deposit insurance. However, as a consequence of this special status, banks are subject to prudential limitations designed to limit risk, promote sound operations, assure impartiality in the credit granting process, and prevent excessive concentration of credit resources. The Bank Holding Company Act represents one of the principal mechanisms for accomplishing these goals through its limitations on the commingling of banking and commerce and the concentration of banking resources.

The framework of regulation created by the Bank Holding Company Act is frustrated, however, to the extent that institutions engaged in banking functions are allowed to secure the benefits of bank status while at the same time their corporate parents evade the prudential limitations on the scope of nonbanking activities that Congress established in the Bank Holding Company Act. Moreover, this situation threatens to undermine the system of bank holding company regulation as a whole since bank holding companies that are subject to the Act's prudential limitations are placed at an increasing competitive disadvantage with respect to the securities, insurance, manufacturing and retail companies that own "nonbank banks" and that are free to establish synergistic relationships between their banking and impermissible nonbanking operations.

It has been suggested that these nonbank bank institutions that are chartered as banks are not engaged in demand deposit taking or in direct commercial lending to customers or clients of the bank and therefore the nonbanking activities of their affiliates do not raise the policy concerns that the Act was intended to address. However, as indicated in more

detail below, these banks raise the same prudential problems as other banks and, in fact, the operating techniques used by nonbank banks do amount to the taking of demand deposits and the making of commercial loans. Moreover, the Board is also concerned with the difficulty of assuring the enforcement of a self-imposed limitation on direct commercial lending where, for example, close links associated with common control would be established between the demand deposit-taking function of the nonbank bank and commercial lending activities conducted through separate corporate subsidiaries of the parent organization.

The possibility of "understandings" involving the placing of funds derived from deposit taking by nonbank banks with banking institutions that would agree to take a favorable view toward lending to the nonbank bank's industrial or commercial affiliates would circumvent the purposes of the Act and pose serious enforcement problems. Similarly, as is discussed below, a nonbank bank could lend to consumers on terms aimed at furthering the purchase of goods or services from affiliates of the nonbank banks. The Act was designed to deal with the potential abuses that could result from concentration of resources and/or from conflicts of interest that inherently arise in the common ownership of banks and commercial organizations, and the potential for these abuses is clearly present in the relationship between nonbank banks and their corporate parents and affiliates.

The legislative history of the Act confirms the fact that Congress was concerned about the use of banking powers in tandem with other commercial and industrial enterprises even where these powers were used exclusively for so-called consumer lending. Congress believed that banks exercising these powers

should be covered by the Act to assure impartiality in lending and prevent the cartelization of industry and commerce around banks. The 1970 report of the Senate Committee on Banking and Currency quotes, and indicates agreement with, the following remarks by former Federal Reserve Chairman Martin:

> If a holding company combines a bank with a typical business firm, there is a strong possibility that the bank's credit will be more readily available to the customers of the affiliated business than to customers of other businesses not so affiliated. Since credit has become increasingly essential to merchandising, the business firm that can offer an assured line of credit to finance its sales has a very real competitive advantage over one that cannot. . . . [I]f we allow the line between banking and commerce to be eased, we run the risk of cartelizing our economy. Just as we have seen the country's largest banks join the new wave of one-bank holding companies, we could later see the country's business firms clustering about banks in holding company systems in the belief that such an affilation would be advantageous, or perhaps even necessary to their survival.[11]

The Congressional concern that banks which were affiliated with other businesses might make loans designed to further the interests of those affiliates is also evidenced in section 4(d) of the Act. This section allows the Board to grant exemptions from the nonbanking prohibitions of the Act for certain companies, including those whose subsidiary banks are

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[11] S. Rep. No. 1084, *supra*, at 3.

so small "as to minimize the likelihood that the bank's powers to grant or deny credit may be influenced by a desire to further the holding company's other interests." 12 U.S.C. § 1843(d). While Congress was prepared to concede that there could be cases where a bank was so small as not to create a situation that was inconsistent with the basic purposes of the Act, it deliberately avoided a blanket size exemption and instead conferred the exemption judgment exclusively on the Board.

The nonbank bank device allows precisely the conflicts of interest and other adverse effects that Congress sought to prohibit in 1970. A nonbank bank is able to make commercial loans by purchasing such instruments as commercial paper, and it may make all types of consumer loans, in association or in tandem with the operations of its commercial affiliates. Moreover, both types of loans may be made without regard to the anti-tying provisions of the Bank Holding Company Act, 12 U.S.C. §§ 1971-78. These provisions prohibit banks from extending credit or furnishing any service, or fixing or varying the consideration for any such extension of credit or service, on the condition that the borrower purchase some other goods or services from a holding company affiliate of the bank, or on the condition that the borrower not obtain some other credit, property or service from a competitor of the bank's holding company affiliates. 12 U.S.C. § 1972(1).

Congress viewed these anti-tying limitations as necessary for the conduct of the additional nonbanking activities permitted for bank holding companies by the 1970 Amendments because of the possibility that such new activities could lead to a variety of adverse effects such as the tying of credit to other

nonbanking services.[12] Under the Board's regulations, a bank holding company and its nonbank affiliates are similarly prohibited from providing products and services on condition that the customer obtain services from the affiliate bank. 12 C.F.R. § 225.4(c) (1983). Under the narrow interpretation of commercial loan relied on by nonbank banks, not only are the activities of the parent of the nonbank bank unlimited, but the nonbank bank itself is free to require that prospective borrowers buy insurance, securities or other goods and services from those affiliates in order to receive an extension of credit from the nonbank bank. The Board believes that the ability of nonbank banks to engage in such coercive practices in order to provide a competitive advantage for their affiliates creates serious competitive inequalities and significantly undermines the structure designed by Congress for the regulation of the nonbanking activities of banks and their holding company affiliates.

In addition, the proliferation of nonbank banks would allow for the expansion of banking across state lines without either state authorization or Congressional approval as is now required by law. While the Board has supported a Congressional reevaluation of the present ban on interstate acquisitions without state approval, interstate acquisitions of so-called nonbank banks would violate both the letter and clear intent of the Douglas Amendment.

In this context the Board has reexamined its interpretation of the terms demand deposits and commercial loan in light of the comments received from the public.

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[12] Statement of the House Managers, *supra*, at 18.

Definition of Demand Deposits.

The final amendments interpret the phrase "deposits that the depositor has a legal right to withdraw on demand" in section 2(c) of the Act as "any deposit with transactional capability that as a matter of practice is payable on demand and that the depositor may withdraw by check, draft, negotiable order of withdrawal, or other similar instrument for payment to third parties."

Several commenters objected to the Board's definition of demand deposits as contrary to the traditional treatment of NOW accounts as savings deposits. These commenters argued that, because institutions offering NOW accounts are required to reserve the right to require 14 days' prior notice of withdrawals, the accounts are not in fact demand deposits. The commenters also objected to the proposed definition as inconsistent with legislative history indicating that certain institutions that currently offer NOW accounts, such as industrial banks and industrial loan companies, were not intended to be treated as banks.

The Board believes, however, that traditional interpretations of the term demand deposits, the regulatory treatment of accounts with transactional capability, the functional equivalency of demand deposits and NOW accounts, and the legislative history and purposes of the Bank Holding Company Act require that NOW and similar accounts be treated as demand deposits for purposes of the BHC Act. The legislative history and purposes demonstrate that the term demand deposits in section 2(c) of the Act cannot be interpreted to turn on the technicality of whether the account is subject to a notice of withdrawal requirement that in practice is never imposed. Such an

interpretation would permit the fundamental purposes of the Act to be circumvented or rendered meaningless simply through the offering of checking accounts that perform the same function as demand deposits, that are advertised as checking accounts, and that for all intents and purposes are the equivalent of a conventional demand checking deposit, but that are not treated as demand checking deposits only because they are subject to a never exercised right of the depository institution to require prior notice of withdrawals. It is a fundamental principle of statutory construction that a statute must be interpreted to give effect to its purposes and to avoid an absurd or unreasonable result. *United States* v. *American Trucking Association*, 310 U.S. 534, 543 (1940).

Legislative History.

As indicated, the legislative history of the Act reflects that, when Congress eliminated the charter test of "bank" status in 1966 in favor of the demand deposit test, it intended to cover checking accounts, like NOW accounts, as demand deposits and did not intend to exclude institutions that function as banks. In 1963, the Board issued an interpretation regarding the coverage of industrial banking organizations, such as industrial loan companies, under the charter test in the original Act. 49 Fed. Res. Bull. 166 (1963). The Board ruled that industrial banking organizations would be banks for purposes of the Act in two situations: (1) if they issued accounts subject to withdrawal by check; or (2) if in actual practice they permitted a withdrawal of deposits on demand. The second part of this test referred to ordinary passbook savings deposits, which are paid on demand but that are not freely withdrawable by check.

Subsequently, during Congressional hearings on the 1966 Amendments to the BHC Act, representatives of industrial banking organizations requested that certain of these institutions be exempted from the Act on the rationale that industrial banks and similar institutions only made loans to consumers, offered savings certificates, and did not accept checking accounts.[13] The Board endorsed this proposal on the basis that the BHC Act should cover only institutions that accept demand or checking accounts.[14] In effect, the Board favored repeal of the second part of its 1963 industrial bank interpretation that covered an industrial banking organization if such institutions limited their deposit taking activities to the offering of passbook savings accounts. The Board stressed, however, that the first part of this test should be retained and industrial banks should continue to be covered if they accepted checking accounts.

Congress adopted the Board's proposals by eliminating the charter test in favor of the demand deposit definition. The legislative history is clear that Congress did not intend to repudiate the first part of the Board's 1963 industrial bank interpretation, and that the authority to offer checking accounts was regarded as the fundamental characteristic of a "bank" under the Act. The Senate Report accompanying the amendments expressly stated that the bank definition was intended to include an institution that

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[13] *Amend the Bank Holding Company Act of 1956: Hearings on S. 2353, S. 2418, and H.R. 7371 before a Subcomm. of the Senate Comm. on Banking and Currency*, 89th Cong., 2d Sess. 155, 157 (1966) (testimony of Max A. Denney, American Industrial Bankers Association) (hereinafter "1966 Senate Hearings").

[14] *Id.* at 447.

accepts deposits payable on demand, which the report described as checking accounts.[15] Senator Robertson, the sponsor of the bill, stated that the amendment covered only institutions that "accept demand deposits subject to check" and excluded industrial banks because they did not accept deposits subject to check. 112 Cong. Rec. 11,794 (1966). Nothing in the reports of the relevant committees or in the statements of the bill's sponsor ever refers to a notice of withdrawal requirement as a prime characteristic of the deposits covered by the Act.[16] Based on this legislative history, the Board concludes that Congress did not intend to exclude from the concept of demand deposit checking accounts that are subject to a formal requirement of notice where the instrument functions in all other respects in the same manner as one that is not subject to such a formal notice.

Thus, following the 1966 Amendments, the Act continued to apply to institutions accepting deposits subject to withdrawal by check, but no longer applied to institutions offering deposits, such as passbook savings deposits, that are in practice paid on demand but which are not subject to withdrawal by check or similar device. The United States Court of Appeals for the Third Circuit has recently held that the retention of the right to require advance notice of withdrawal is *not* necessarily determinative of whether a

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[15] S. Rep. No. 1179, 89th Cong., 2d Sess. 7 (1966).

[16] While the language adopted in the 1966 Amendments differed from that proposed by the Board ("deposits payable on demand"), there is no indication in the legislative history that this change was intended to be substantive. Indeed, as noted, the Congress consistently referred to the change as encompassing "checking accounts."

particular type of deposit is a demand deposit under the BHC Act:

> Congress did not choose the words "accepts deposits that the depositor has a legal right to withdraw on demand" because it was concerned with the distinction between a depositor's *legal* right to withdraw on demand and the ability *in practice* to withdraw on demand. The more reasonable interpretation of why Congress selected these terms is that stated in the [1966] Senate Report . . . Congress was merely adopting "the commonly accepted test of whether an institution is a commercial bank." [17]

Administrative Interpretations. The term "demand deposit" has been used in many earlier federal banking laws and over the years had uniformly been interpreted to include any deposit, such as a NOW account, that is withdrawable by check regardless of whether the deposit is subject to a notice of withdrawal requirement. As early as 1915, the Board recognized the right of an institution to require advance notice of withdrawal as a distinguishing factor of a savings account, but made clear that, where a notice account was ordinarily subject to withdrawal by check, that account would be treated as a demand deposit and would be subject to the higher level of reserves applicable to demand deposits. 1 Fed. Res. Bull. 38 (1915).[18] In 1933, the Board, in defining de-

[17] *Wilshire Oil Co.* v. *Board of Governors*, 668 F.2d 732, 737 (3d Cir. 1981), *cert. denied*, 457 U.S. 1132 (1982) (emphasis in original).

[18] *See* 1 Fed. Res. Bull. 73 (1915) (savings deposits subject to check); 9 Fed. Res. Bull. 677 (1923) (special savings accounts against which an unlimited number of checks can be

mand deposit for purposes of the prohibition against the payment of interest on accounts payable on demand, included savings accounts subject to withdrawal by check, notwithstanding the fact that the savings account had an advance notice of withdrawal requirement. The Board explained that such action was necessary to prevent evasion of the statutory prohibition since accounts subject to a notice requirement typically pay interest and reflected the Board's view that checkable notice of withdrawal accounts were functionally demand deposits.[19] 21 Fed. Res. Bull. 792, 863 (1935).

Thus, at the time of the 1966 amendment of the "bank" definition to cover demand deposits, that term had a well-defined meaning under longstanding agency interpretation and included all checkable deposits regardless of a notice of withdrawal requirement. The Board believes that, since the legislative history repeatedly refers to demand deposits as "checking accounts" it is likely that Congress meant to incorporate the longstanding agency interpretation into the statute.[20]

drawn); 13 Fed. Res. Bull. 609 (1927) (special reserve savings accounts that "in actual practice" are subject to check).

[19] In *United States League of Savings Associations* v. *Board of Governors*, 595 F.2d 888 (D.C. Cir.) (table), *cert. denied*, 444 U.S. 920 (1979), the District of Columbia Circuit obviously believed that a deposit ar[illegible]gement that functions as a checking account should be trea[illegible] as such regardless of the retention of a notice of withdrawal requirement. The Tenth Circuit has adopted the same view in invalidating a similar deposit arrangement offered by certain savings and loan associations. *Otero Savings & Loan Association* v. *Federal Home Loan Bank Board*, 665 F.2d 279 (10th Cir. 1981).

[20] *See Lorillard* v. *Pons*, 434 U.S. 575, 580-81 (1978) (When Congress incorporates prior statutory language in new stat-

Function of NOW accounts as checking accounts. NOW accounts in practice perform the same function as conventional demand deposits, are advertised and used in a manner indistinguishable from conventional bank checking accounts, and are subject to the same reserve requirements as conventional demand deposits. It is uniformly recognized that NOW accounts operate as demand checking accounts and that checks drawn on these accounts are paid by the drawee institutions on demand, just like conventional checking accounts. *E.g., New York State Bankers Association* v. *Albright,* 38 N.Y. 2d 430, 381 N.Y.S. 2d 18, 343 N.E. 2d 735 (1975) ("Manifestly and unabashedly", the NOW account is intended to be the equivalent of a checking account); Kaplan, *Federal Legislative and Regulatory Treatment of NOW Accounts,* 91 Banking L.J. 439, 440 (1974) ("NOW accounts permit money transfers to third parties in much the same manner as conventional checking accounts").

Like a conventional checking account, the holder of a NOW account makes withdrawals by means of a demand draft that may be issued to a third party as a means of transferring funds to the third party from the depositor. The payee of the NOW draft deposits it in the payee's bank for collection from the drawee institution. The drawee institution then charges the depositor's NOW account to pay the draft. *See New York State Bankers Association* v. *Albright, supra.* NOW drafts are cleared through the Federal Reserve check collection facilities as demand items, exactly like conventional checks.

Because of the third party payment feature, NOW accounts are used by depositors to pay bills and to

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ute, Congress is presumed to have incorporated longstanding administrative interpretations of earlier statutory language.)

perform other financial transactions, the very function of a conventional demand deposit. A survey conducted by the American Bankers Association of the operation of NOW accounts in New England, where such accounts were first permitted on an experimental basis, concluded that:

> . . . a large number of depositors are using the NOW accounts as their *main transaction account.* Indeed, some New England banks report that usage of NOW accounts closely resembles the usage of demand deposit accounts.[21]

The Board notes that NOW accounts are uniformly advertised as checking accounts with little, if any, reference to the fact that they may be subject to a 14-day notice of withdrawal requirement. Not only is the right to require advance notice of withdrawal ordinarily not invoked with respect to such accounts, but it is apparent from the nature of a NOW account that, once a draft has been drawn on such an account, the funds in the account that cover the draft cannot effectively be made subject to a notice of withdrawal requirement. Because withdrawals from NOW ac-

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[21] Hoffman and Herman, *NOW Accounts in New England* in American Bankers Association, Studies on the Payment of Interest on Checking Accounts 31 (1976) (emphasis added). *See also* Cates and Chase, *The Payment of Interest on Checking Accounts: A Report to the South Carolina Bankers Association* 29-30 (1976) (NOW experience in Massachusetts and New Hampshire indicates most holders of commercial bank NOW accounts use them as substitutes for regular demand deposit accounts); Simpson and Williams, *Recent Revisions in the Money Stock,* 67 Fed. Res. Bull. 539, 542 (1981) (70 to 80 percent of funds deposited in new-type checking accounts, *e.g.,* NOW accounts, opened in early 1981 were shifted from conventional demand deposits).

counts are made by demand drafts issued directly to third party payees, the drawee institution would face a serious loss of good will if it attempted to invoke that right against drafts drawn against the NOW account.[22] The Board is aware of no instance in which the notice requirement has been invoked on a NOW account.[23]

The history of the federal NOW account authorization legislation evidences the Congressional understanding of such accounts as demand deposits. The 1974 prohibition of NOW accounts (except in certain New England states) was a direct response to and recognition of the fact that the ability to make withdrawals by check converted the traditional in-

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[22] By refusing temporarily to pay NOW drafts on demand, the institution would refuse payment, not to the holder of the NOW account, but to a third party payee, such as a merchant, who has no necessary relationship with the institution and who has given value for the NOW draft. Payees would thereafter refuse to accept NOW drafts drawn on that institution. NOW account depositors would thus be forced to withdraw the NOW account funds and place them in a more acceptable payment vehicle. Also, under federal law, an institution that wishes to invoke the notice of withdrawal requirement is obligated to impose such a requirement on every other account of a similar nature. 12 C.F.R. § 217.5(a).

[23] The notice requirement on occasion has been invoked with respect to ordinary savings accounts, which do not contain funds used to pay bills and are not checkable. *See* American Banker, June 22, 1976, p. 1, col. 2. Because the Board's interpretation concerns only accounts subject to the notice of withdrawal requirement that are *withdrawable by check*, it does not cover savings deposits, which are subject to the notice of withdrawal requirement but may not be withdrawn by negotiable order and thus that do not have transactional capability. *See* 12 C.F.R. § 217.5(c) (1).

terest-bearing savings account into a demand deposit and represented a device to circumvent Congress' 1933 ban on the payment of interest on demand deposits.[24] In effect, the legislation codified the Board's longstanding view that a checking account is functionally a demand deposit.[25] Indeed, if NOW accounts are not demand deposits, there would have been no need at all for legislation authorizing NOW accounts, since the prohibition on payment of interest applies only to deposits *payable on demand* and not to ordinary savings accounts.[26]

Finally, the Monetary Control Act of 1980 requires depository institutions to maintain the same level of reserves against NOW accounts as are required to be maintained with respect to conventional demand de-

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[24] 119 Cong. Rec. 16,071 (1973) (Remarks of Senator Brock stating, "Failure to ban "NOW" accounts infringes on a *40-year old statutory prohibition on the payment of interest on checking accounts*.") ; *Id.* at 15,005 (Remarks of Cong. Johnson stating, unless NOW accounts are limited, "the net result will be nationwide, all banks will pay interest on *checking accounts*.") ; *Id.* at 15,002 (remarks of Rep. Patman, characterizing NOW accounts as permitting interest on *demand deposits*) ; *Id.* at 16,486 (remarks of Sen. Proxmire to the effect that NOW accounts permit "one to earn interest on his *demand deposits*").

[25] S. Rep. No. 368, 96th Cong., 1st Sess. 5 (1979). "[NOW accounts] are the functional equivalent of interest bearing checking accounts." *Accord* 125 Cong. Rec. H7613 (daily ed. Sept. 10, 1979) (Remarks of Cong. St Germain).

[26] The fact that NOW accounts are limited to consumers has no significance under the BHC Act, in which the definition of "bank" depends on the *demand checking* feature of *deposits*, not on the commercial or consumer nature of the depositor (unlike the loan part of the "bank" definition).

posits.[27] This requirement reflects the Congressional belief that these accounts are functionally equivalent and form the basis of our country's medium of exchange. H.R. Rep. No. 263, 96th Cong., 1st Sess. 4 (1979). Thus, the Monetary Control Act also in effect codified the Board's early administrative rule that imposed on *checkable* accounts (whether or not subject to a notice of withdrawal requirement) the same reserve requirements applicable to conventional demand deposits.

Several commenters stated that the proposed definition of demand deposit is overly broad and could cover some types of institutions that should not be covered. The Board is aware that, under its interpretation, industrial banks and similar institutions that may currently offer NOW accounts and make commercial loans will be covered as "banks" under the Act. As noted, the legislative history of the Act manifests a Congressional intent not to cover such institutions as they operated in 1966. The intent was premised upon the belief and the testimony of the industrial banking industry before Congress that such institutions did not offer checking accounts or engage in the commercial loan business. In recent years, industrial banks and similar organizations have been authorized to offer NOW checking accounts and to make commercial loans. Clearly, in light of this significant departure from the traditional and commonly accepted functions of industrial banking organizations, these institutions, which function essentially as banks, are not the type of institution Congress intended to exclude from the Act in 1966.

[27] 12 U.S.C. § 461(b)(1)(C). In contrast, Congress mandated no reserve requirement for traditional savings deposits. *See* 12 C.F.R. § 204.9(a).

Indeed, in the Garn-St Germain Act of 1982, Congress recognized the essential bank-like functioning of industrial banks and specifically made them eligible for FDIC insurance.[28]

The Board believes that institutions that both offer NOW accounts, or other accounts that clearly are the functional equivalent of a demand deposit, and make commercial loans must be treated as banks in the interests of competitive equity and to prevent evasion of the Act and to ensure that its fundamental purposes are effected.

Some commenters stated that the proposed definition of demand deposit could call into question the status of certain types of accounts, such as money market deposit accounts, preauthorized transfer accounts, telephone transfer accounts, accounts accessible through ATM machines, various types of bill-payer accounts, and credit balance accounts accessible by negotiable check or draft. Under certain circumstances, it is possible that some of these accounts may fall into the category of deposits that the Board regards as demand deposits, especially if they function as checking accounts or the equivalent thereof. However, the Board does not believe it is necessary to treat such accounts as demand deposits for purposes of the regulation as currently written, since it is unlikely that there would be a significant number of depository institutions offering these accounts that do not also offer NOW or other checking accounts.

In this regard, the inclusion of the definition of demand deposits in Regulation Y should not be interpreted as affecting the present status of credit balances offered by investment companies chartered un-

[28] Pub. L. No. 97-320, § 703, 96 Stat. 1469, 1538-39, S. Rep. No. 536, 97th Cong., 2d Sess. 43 (1982).

der Article III of New York's banking law, which the Board has previously determined are not demand deposits for purposes of the Act. *European-American Bancorp*, 63 Federal Reserve Bulletin 595 (1977). The Board may determine to review the status of such credit balances at some future date upon request or upon the Board's own initiative, but does not intend by this action to address these types of accounts. Similarly, the Board's interpretation of demand deposits does not affect the status of deposits accepted in a *bona fide* fiduciary capacity, which the Board has determined are not demand deposits for purposes of the Act.

In the comments, concern also was expressed that the definition of demand deposit would result in the forced divestiture of some industrial loan company subsidiaries of bank holding companies that do not meet the eligibility requirements for FDIC insurance. Section 3(e) of the BHC Act requires that every bank that is a subsidiary of a bank holding company be insured by the FDIC. 12 U.S.C. 1842(e). This provision was added to the BHC Act at the Board's suggestion based on the Board's belief that the value of federal deposit insurance to the public is such that all banks should offer this service to their customers. *See Mercantile Bankshares Corporation*, 56 Federal Reserve Bulletin 596 (1970). The Board notes that, under the Act, an institution that qualifies as a bank under the Board's interpretation and that is owned by a company would be allowed two years to obtain FDIC insurance. This will provide time for Congress to consider amending section 3(e) of the Act to allow other types of qualified insurance as an alternative to FDIC insurance.

Concern also was expressed in the comments that, if NOW accounts are deemed to be demand deposits,

banks would no longer be permitted to pay interest on such accounts. The Board stresses, however, that a determination that NOW accounts are demand deposits for purposes of the BHC Act does not affect their status under other federal statutes. In particular, the Board's interpretation does not prevent institutions from continuing to pay interest on NOW accounts.

For the above reasons, the Board concludes that demand deposits in the bank definition include NOW accounts and similar deposits that the depositor may withdraw by check, draft, negotiable order of withdrawal, or similar instrument. Accordingly, the Board is adopting in Regulation Y the definition of the term demand deposit as proposed, with certain technical modifications.

Definition of Commercial Loan

In order to qualify as a bank under the BHC Act, an institution must, in addition to accepting demand deposits, be engaged in the business of making commercial loans. The final regulation reflects the Board's definition of commercial loan as a loan the proceeds of which are used other than for personal, family, household or charitable purposes. Moreover, as noted above, even consumer loans, when made to further a commercial purpose, such as to promote an affiliate's business, would be considered a commercial loan under the Act.

The final regulation includes as a commercial loan the purchase of such instruments as commercial paper, bankers acceptances and certificates of deposit, the extension of broker call loans, the sale of federal funds, and similar transactions. Some commenters have objected to the proposed inclusion of commercial

paper, certificates of deposit, bankers acceptances and federal funds as commercial loans as beyond the scope of the Board's authority under the Act and contrary to the terms of the Act and established Board interpretations thereof. The commenters state that these transactions are not loans, but rather passive investments, which typically are short term and effected through a secondary market as a means of investing idle funds or maintaining liquidity, and that these transactions do not present the evils of credit abuse and concentration of economic power at which the Act is aimed. These commenters also state that the definition would bring under the Act many institutions that were not intended to be covered.

The Board has considered these comments and, for the reasons set out below, has determined to adopt the definitions as proposed with certain modifications.

In the Board's judgment, these instruments as a matter of law establish a debtor-creditor relationship and constitute an extension of credit or loan. Since these loans result in the provision of funds to commercial enterprises, including banks, which are also commercial enterprises, and since they are not made for personal, family, household or charitable purposes, these loans are commercial loans for purposes of the bank definition in the Act.[29] Moreover, as set forth above, the Board believes this interpretation to be consistent with and necessary to ensure implementation of the Act, prevent evasions of its fundamental purposes, and carry out expressed legislative policies.

[29] Federal, state and local governments and their agencies are not regarded as commercial enterprises by the Board, and their debt obligations therefore would not be regarded as commercial loans.

Some commenters argue that the term commercial loan must be applied to encompass only those transactions traditionally denominated "commercial loans" by the parties to the transactions. There is nothing in the legislative history that supports such a proposition. On the contrary, the thrust of the 1970 Amendments was to cover all banking institutions regardless of size because such action was necessary to prevent the potential for the abuses about which Congress was concerned—conflicts of interest, risk, partiality in the granting of credit, and concentration of resources. In fact, the instruments covered by the Board's definition are loans to commercial enterprises, and institutions which engage in banking functions by accepting demand deposits and making such commercial loans are subject to the potential abuses which Congress sought to prevent through a broadly applicable Bank Holding Company Act.

Moreover, the interpretation proposed by the commenters would deny to the Board any authority to prevent evasion of the Act by covering instruments that are in fact loans to commercial enterprises but take non-traditional forms. This approach would permit banks to structure their lending transactions to avoid the coverage of the Act and to circumvent its purposes. The courts, however, have recognized the authority of the Board to look beyond form to the substance of a transaction in order to prevent an evasion of the purposes of the Act.[30]

As a first and preliminary matter, all of the instruments covered by the Board's definition are in

[30] *See Wilshire Oil Co., supra* at 739-40. Indeed, the court agreed that section 5(b) of the Act enables the Board to prohibit activities that are technically outside the literal terms of the Act in order to prevent a clear evasion of the purposes of the Act. *Id.* at 740.

a technical legal sense "loans" since a debtor-creditor relationship is created in each. The term "loan" is generally defined as any transaction as a result of which a party advances money and obtains an absolute promise to repay, and generally involves the following elements: a principal sum placed with a borrower, an agreement that interest is to be paid on that sum, and a recognition by the receiver of the money of a liability for the return of the principal amount with interest. *See e.g.* Black's Law Dictionary 1085 (4th rev. ed. 1968). As explained in detail below, each of the instruments creates a debtor-creditor relationship meeting these standards and thus falls within the term "loan" in section 2(c) of the Act.

Second, the definition in section 2(c) requires that the loan be "commercial." The Supreme Court has stated that "[c]ommercial loans, generally speaking, are relatively short-term loans to business enterprises of all sizes, usually for purposes of inventory or working capital." *United States* v. *Connecticut National Bank*, 418 U.S. 656, 665 (1974). As indicated, the instruments listed in the regulation provide funds to commercial organizations, as in the case of commercial paper and bankers acceptances, or, as in the case of certificates of deposit or federal funds, to banks, which also are commercial enterprises.[31] Moreover, the maturity, interest rate, and credit risk of all of these instruments is generally comparable to that of a short-term, prime quality commercial loan.[32] Each of these instruments typically provides short-term funding for working capital or current operations such as the financing of inventory. In addition, for each of these instruments, the lender generally will not extend funds unless it or a third party has accomplished a credit analysis to demonstrate that the borrower is capable of repaying the extension of credit from current income. In short, the instruments described in the Board's definition are loans for a commercial purpose—in other words, commercial loans.

The following discussion demonstrates that, both in terms of function and in terms of the legal obligation created, the instruments covered by the regulation are commercial loans for purposes of the BHC Act.

Commercial Paper. Commercial paper is a prime quality, short-term unsecured promissory note establishing a debtor-creditor relationship between lender and borrower. It is generally used as a financing device by large, financially strong corporate borrowers to obtain funds for seasonal or working capital purposes such as the financing of inventory. The maturity of commercial paper is generally 60 days or less, although it can have a maturity of up to 270 days. Commercial paper is generally sold in denominations of $100,000 or more. Although it is negotiable, it is generally held to maturity and interest rates are fixed.[33]

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[31] *See United States* v. *Philadelphia National Bank*, 374 U.S. 321, 343 (1963).

[32] Although some commercial loans are of medium term, the traditional commercial loan is a short term instrument. *United States* v. *Connecticut National Bank*, 418 U.S. 656, 665 (1974); Munn and Garcia, *Encyclopedia of Banking and Finance* 572 (8th rev. ed. 1983); Stigum, *The Money Market* 76 (1983).

[33] Stigum, supra, at 625-41; Hurley, *The Commercial Paper Market*, 63 Federal Reserve Bulletin 525 (1977); Munn and Garcia, *supra* at 196. Interest is usually paid on commercial paper on a discount basis.

It is uniformly agreed that the purchase of commercial paper by a bank is a commercial lending transaction. Indeed, the Comptroller of the Currency has taken the position that the purchase of commercial paper is "after all nothing but [a] loan to industrial corporations" and thus qualifies as a loan under the lending limitations in the National Bank Act and under the Glass-Steagall Act. Letters of February 24, 1972, and November 19, 1971. The term and denomination of commercial paper, its status as a promissory note; the uses to which the funds are put, and the type of credit analysis involved, all mean that commercial paper is a commercial loan for purposes of the BHC Act.[34]

Certificates of Deposit. A certificate of deposit ("CD") is an instrument evidencing a deposit with a bank for a specified period of time, generally at a fixed rate of interest. The legal relationship established between the purchaser of a certificate of deposit and the bank that issues it is that of creditor and debtor, and the loan that the purchaser of the instrument effectively makes to the bank is an unsecured loan.[35] As is the case with commercial paper,

[34] Moreover, in terms of function, commercial paper is an important substitute for commercial loans from banks, and the amount of such paper outstanding often increases or decreases as a result of changes in the cost and availability of bank loans. Hurley, *supra*, at 525. Indeed, the origins of commercial paper in the early 19th century can be traced directly to the inability of the U.S. banking system to provide sufficient credit for larger corporations that experienced significant seasonal swings in their need for credit. Stigum, *supra*, at 626.

[35] Bankers Desk Reference 84 (1978). *See Sutter* v. *Groen*, 687 F.2d 197, 200 (7th Cir. 1982) (certificate of deposit issued by bank and insured by FDIC is "a type of promissory note");

large denomination CDs that are traded in the money market are usually short-term, negotiable instruments, and typically have a maturity of from one to six months. The minimum denomination of such CDs is usually $1 million.[36]

The use of large denomination CDs with negotiable rates and maturities was originated by large banks in the 1960s as a method of providing additional funding for their operations, and has now become a key funding source for banks.[37] Banks use large denomination CDs to provide short term funding for their commercial operations in the same manner that other business organizations use commercial paper to raise working capital.[38] Moreover, as is the case with purchasers of commercial paper, purchasers of large

Wightman v. *American National Bank*, 610 P. 2d 1001, 1004 (Wyo. 1980) ("a certificate of deposit is simply a commercially glamorous name for a promissory note"); 2 *Anderson on the Uniform Commercial Code* 615 (1971) ("The differences between a certificate of deposit and a promissory note are merely formal. In substance and legal effect the two instruments are the same. . . .").

[36] Stigum, *supra* at 525-26; Munn and Garcia, *supra*, at 608.

[37] Stigum, *supra* at 107. By 1960, the demand for loans at large New York City banks significantly exceeded the ability of those banks to fund loans from traditional sources such as savings deposits. At the same time, many large corporations had money they would be prepared to lend to large banks if the instrument evidencing the loan provided a relatively high rate of return and was negotiable. The large denomination CD satisfied this need. *Stigum, supra* at 35-36, 107-08.

[38] Controlling the amount of CDs that it issues is one of the principal devices by which a bank can make short term adjustments to the volume of loans it has outstanding. Thus, when loan demand is up, banks issue more CDs in order to make more loans. Stigum, *supra* at 36, 107.

denomination CDs engage in credit analysis of the issuers of these instruments, and establish limits for the amount that they are prepared to purchase from any particular issuer.[39] In sum, for purposes of the Bank Holding Company Act, a large denomination certificate of deposit is a commercial loan.

Some banks purchase CDs in denominations as small as $100,000. Since such CDs are fully insured by the FDIC, they involve no credit risk. In all other respects, however, such CDs function as commercial loans to other banks, presenting the same potential for conflicts of interest and concentration of resources as other commercial loans. When a bank regularly purchases CDs of other banks, or otherwise makes interest bearing deposits on a regular basis, the Board believes the purchasing bank is engaged in the busines of making commercial loans.[40] The Board's commercial loan definition therefore encompasses the regular purchase of smaller CDs or other interest bearing deposits.[41]

[39] Stigum, *supra* at 530. As a result of this fact, even the largest banks can experience difficulty in issuing CDs if their performance raises market concerns.

[40] The Board regards this construction of the term "engaged in the business" as being necessary to prevent evasion of the statute. It is also consistent with judicial construction of similar language in other statutes. *SEC* v. *Fifth Avenue Coach Lines*, 289 F. Supp. 3, 30-31 (S.D.N.Y. 1968). *Cf. Buckley* v. *New York Times*, 215 F. Supp. 893, 894 (E.D. La. 1963). Although the Board used a somewhat higher threshold with regard to Boston Safe, and certain savings and loan associations, the status of Boston Safe as a trust company and the independent regulatory scheme for savings and loan associations distinguishes those prior decisions.

[41] On the basis of existing evidence, however, the Board does not believe that a non-interest bearing demand deposit is likely to function as a commercial loan, and such deposits are not covered by the definition of commercial loan.

Federal funds transactions. Federal funds transactions represent interest bearing loans by one depository institution of its deposits with a Federal Reserve Bank to another depository institution, generally on an overnight basis.[42] The so-called "sale" of federal funds is not only legally the making of an unsecured loan to the purchasing bank, but it is so regarded by bankers.[43] Consequently, banks assess the credit risk associated with these transactions, and they will normally lend federal funds only to banks to which they have granted a line of credit.[44] Indeed, the Board has stated that the sale of federal funds is an unsecured loan from one depository institution to another.[45] Moreover, the purchase of Federal funds in substantial amounts on a regular basis is viewed by large financial institutions (which are themselves commercial enterprises) as a method of satisfying their basic funding needs.[46] In view of these facts, the Board concludes that federal funds should be regarded as commercial loans for purposes of the Act.

Bankers' Acceptances. A bankers' acceptance is an interest bearing loan—a debtor-creditor relationship—in the form of a draft with a payment date several months in the future that is drawn by a busi-

[42] *Bankers Desk Reference*, 301-02, 367 (1978); Stigum, *supra* at 33-34, 105.

[43] Stigum, *supra* at 105.

[44] *Id.*

[45] Letter of June 8, 1972, to Laurence H. Stone regarding Boston Safe Deposit and Trust Company. In the context of Boston Safe's trust company activities, the Board concluded that sales of federal funds by Boston Safe were loans but were not commercial loans.

[46] Stigum, *supra* at 374-76.

ness on a specified bank, and that has been accepted for payment by that bank.[47] The use of bankers acceptances provides an alternative to a direct extension of commercial credit for the business which initially secures the letter of credit under which the draft is drawn.[48] By accepting the draft, the issuing bank has made the draft a primary obligation of the bank. After creating the acceptance, the bank may discount it and retain the instrument until maturity as part of its commercial loan portfolio. Alternatively, in order to raise funds to be used in the bank's current business, it may sell the acceptance in the money market. The buyer of the acceptance receives an unconditional promise from the selling/accepting bank that it will pay the draft at maturity. In turn, the accepting bank looks to the business that is the account party on the draft for repayment; the purchaser of the acceptance may also recover from the account party if the accepting bank defaults.

The direct effect of purchasing a bankers' acceptance is to provide funds to the accepting bank, which is itself a commercial enterprise.[49] Moreover, in view of the liability of the business that is the account party on the draft, the purchase of a bankers' acceptance from the accepting bank or any other party is the functional equivalent of purchasing a commercial loan that is guaranteed by the accepting bank. On the basis of the preceding discussion, the Board

[47] *Bankers Desk Reference* 304 (1978); Munn and Garcia, *supra* at 69-71. Interest is paid on a discount basis.

[48] Stigum, *supra* at 39.

[49] The purchase of a bankers acceptance from a dealer in such instruments similarly provides funds to the dealer, which is a commercial enterprise.

concludes that the purchase of a bankers' acceptance should also be regarded as a commercial loan.

Some commenters have objected to the inclusion of these money market instruments as commercial loans on the basis that they are often purchased through brokers with no direct negotiation with the issuer, and should therefore be classified as passive investments rather than commercial loans.[50] However, a substantial portion of the transactions in all of these instruments occurs through direct negotiations between lenders and borrowers and, even when purchased through brokers, the lender knows the borrower's identity. Based on its experience, the Board is aware that holders of large amounts of so-called money market instruments relative to the size of the borrower are in a position to influence the conduct of the borrower, and do at times exercise this influence.[51]

[50] The absence of direct negotiation with the borrower is a characteristic of the purchase of a participation interest in a direct extension of commercial credit, a technique commonly used by commercial banks to spread the risk of default and increase the total amount of funds that may be loaned to one customer. It is only the "lead" bank in a participated lending transaction that typically negotiates directly with the borrower. However, most courts that have considered the issue have concluded that a bank that purchases a participation in a commercial loan is purchasing a commercial loan rather than a security. *E.g., Union Planters National Bank* v. *Commercial Credit Business Loans, Inc.*, 651 F.2d 1174 (6th Cir.), *cert. denied*, 45 U.S. 1124 (1981).

[51] For the most part, the influence that any lender has over a borrower in an arms-length transaction is likely to be an influence that encourages moderation and prudence. It is the potential for abuse of this relationship, however, that prompted Congress to enact the Bank Holding Company Act. Indeed, in deciding to extend the Acts' coverage to one-bank holding companies, Congress stated that there had been "no

Moreover, a "nonbank bank" could, for example, favor its affiliates by purchasing the CDs or commercial paper of those affiliates, or by purchasing such instruments from customers of its affiliates. Similarly, it could refuse to purchase such instruments from competitors of its affiliates and, as noted above, "understandings" could well develop that would lead to commercial lending by indirect means, *e.g.*, through affiliated commercial finance companies or other reciprocal lending arrangements.

Thus, the Board finds that the financial instruments discussed above are, in fact, properly categorized as loans providing for the extension of credit from one commercial enterprise to another. Moreover, the Board believes it is proper to include these instruments within the scope of the term commercial loan as used in the Act in order to carry out the Act's basic purposes: to maintain the impartiality of banks in providing credit to business, to prevent conflicts of interest, and to avoid concentration of control of credit. As noted above, the proliferation of nonbank banks owned by companies of very substantial size outside the prudential rules of the Bank Holding Company Act suggests that the dangers of evasion of the Act are real and that action to remedy potential abuses is both necessary and desirable.

Several commenters asserted that commercial paper, certificates of deposit and other money market instruments are merely passive investments having the characteristics of a security rather than a loan. Although an occasional purchase of commercial paper,

major abuses effectuated through the one-bank holding company device . . . the legislation is to prevent possible future problems rather than to solve existing ones." S. Rep. No. 1084, *supra*, at 4.

a certificate of deposit or other money market instrument would not mean that the purchaser is engaged in the business of making commercial loans, this has little relevance for a bank that regularly purchases such instruments as one of its basic business operations.[52] Moreover, a commercial loan may be characterized as an investment and vice versa.[53]

Although for purposes of the Bank Holding Company Act, the distinction between a commercial loan and an investment appears largely irrelevant, the distinction has been made for the purposes of certain federal securities laws.[54] The cases interpreting these statutes have set forth certain criteria for distinguishing a transaction that is essentially a commercial loan from a transaction that is essentially an investment embodied in a security regulated by the federal securities laws. Under the criteria employed

[52] The Board regards an institution that engages in such transactions on anything more than an occasional basis as being engaged in the business of making commercial loans. See n. 40, *supra*.

[53] In *C.N.S. Enterprises, Inc.* v. *G&G Enterprises, Inc.*, 508 F.2d 1354, 1359, *cert. denied*, 423 U.S. 825 (1975), the U.S. Court of Appeals for the Seventh Circuit made precisely this point when it stated: "In one sense every lender of money is an investor since he places his money at risk in anticipation of a profit in the form of interest. Also in a broad sense every investor lends his money to a borrower who uses it for a price and is expected to return it one day."

[54] *See, e.g., American Bank & Trust Company* v. *Wallace*, 702 F.2d 93 (6th Cir. 1983); *Bellah* v. *First National Bank of Hereford, Texas*, 495 F.2d 1109 (5th Cir. 1974); *Great Western Bank & Trust* v. *Kotz*, 532 F.2d 1252 (9th Cir. 1976). *Cf. Marine Bank* v. *Weaver*, 455 U.S. 551 (1981); *Exchange Nat. Bank* v. *Touche Ross & Co.*, 544 F.2d 1126 (2d Cir. 1976).

in these cases, the purchase by a financial institution of commercial paper, certificates of deposit, bankers acceptances or the sale of federal funds possesses the qualities primarily associated with a loan rather than these qualities associated with a security.[55]

Some commenters asserted that the purchase of retail installment loans by a bank should not be regarded as involving commercial lending, because the ultimate recipient of the funds are consumers. However, the effect of purchasing an installment loan is to finance the day-to-day operations of the retailer involved, and to provide funds with which the retailer may purchase additional inventory or finance retail sales. Thus, the effect of the purchase is to promote the retailer's commercial business. Moreover, if the retailer is an affiliate of the lending bank, the purchase of its retail installment paper by the bank is precisely the type of transaction criticized in the legislative history of the Act, as discussed above—the retail affiliate has an assured line of credit to finance its sales, thereby giving it an advantage over its competitors. Even though a purchase of such loans may not involve an affiliate, and may be without recourse, the bank is supplying funds to a commercial enterprise, and the retailer generally maintains an ongoing business relationship with the bank, which provides the bank with an opportunity to influence the retailer's affairs through its willingness to continue to provide or deny additional credit. Thus, consistent with a 1976 Board staff opinion, the Board regards the purchase of retail installment loans as a commercial lending transaction, and is so modifying its commercial loan definition in the regulation.

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[55] *Id.*

One other type of loan specified as a commercial loan in the regulation adopted by the Board is a broker call loan. A broker call loan is a loan to a securities broker or dealer that is payable on demand and is made for the purchase or carrying of securities. Munn and Garcia, *supra*, at 137, 154. The Board's staff issued an opinion in 1976 that such loans are not commercial loans on the basis that such loans are a passive medium of investment that do not involve a close lender-borrower relationship. Letter of January 26, 1976.

However, broker call loans are loans; they are clearly made for commercial purposes; and they thus fall within the Bank Holding Company Act's definition of commercial loan. While the staff's interpretation may have been appropriate in a different factual context, in view of the rapidly expanding use of the nonbank bank loophole to evade the BHC Act as described above, the Board believes it is appropriate to regard broker call loans as commercial loans.[56]

Several commenters asserted that the Board's proposed commercial loan definition represented an abrupt and unwarranted reversal of prior positions taken by the Board. The fundamental rule which the Board established in 1971 is that the term "commercial loan" should encompass all loans other than a loan the proceeds of which are used to acquire property or services used by the borrower for his own personal, family, or household purposes, or for charitable purposes. Letter of July 1, 1971, to Greater

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[56] Trust company subsidiaries of bank holding companies are permitted to make broker call loans and purchase money market instruments. However, such subsidiaries are not permitted to accept general purpose demand deposits, and therefore are not "banks" under the bank definition.

Providence Deposit Corporation. In only three subsequent cases [57] over a ten-year period was the Board prepared to allow companies that could not qualify as bank holding companies to engage in demand deposit-taking while placing those deposits in money market commercial loans. The decisions in these cases represented a willingness by the Board to refrain from applying the full scope of the Act in conditions that did not appear to generate the potential for its evasion. Now that conditions have changed so that widespread evasion of the statute has developed through the combination of demand deposit-taking and the placing of the funds thus generated in money market commercial loans, regulatory action to apply the Act to all kinds of demand deposits and commercial loans is necessary.

The courts have held that an agency may alter its interpretations in response to changing circumstances if it provides a reasoned explanation for its action. In *American Trucking Association, Inc.* v. *Atchinson, Topeka & Santa Fe Railway Co.*, 387 U.S. 397, 416 (1967), the Supreme Court ruled that:

> Regulatory agencies do not establish rules of conduct to last forever; they are supposed, within the limits of the law and of fair and prudent administration, to adopt their rules and practices to the nation's needs in a volatile, changing economy.

In its *Dreyfus* decision and in this notice, the Board has detailed the factors and considerations that underlie its interpretation and believes that its action, as explained herein, is both appropriate and necessary in light of the purposes of the Act and is within the Board's express authority under section 5(b) of the BHC Act. Moreover, the Act clearly contemplates changes in interpretation to address changes in market conditions in order that the fundamental purposes of the Act be maintained and to prevent a serious competitive imbalance between competing institutions fostered by the change in market conditions. The definition of demand deposit and commercial loan that the Board has adopted will accomplish these objectives.

[57] Letters of June 8, 1972, to Laurence H. Stone; March 11, 1981 to Mr. Robert C. Zimmer; and May 28, 1981, to Mr. R. S. Miller, Jr.

The Board's action on the definition of the term "bank" as used in the Act is also intended for the purpose of maintaining the structure established by Congress for limiting the association of banking and commercial enterprises in order to avoid the preemption of Congressional discretion through actions that have the effect of evading the Act. Various proposals to confirm or change the present structure are now before the Congress and the ability of Congress to act on these proposals would be limited by rapid expansion of the use of nonbank banks. Changes in the basic framework established by Congress are properly a matter for Congressional decision and the Board looks to legislative action in the near future to clarify both the proper dividing line between commerce and banking and to establish the proper scope of bank holding company powers to deal with changed market conditions.

Accordingly, for the reasons set out above, the Board is adopting in Regulation Y, with certain technical modifications, the definition of the term "commercial loan" as proposed, and in addition is incorporating in that definition the purchase of retail installment loans.

APPENDIX C

[SEAL]

RICHARD F. CELESTE
Governor

STATE OF OHIO
DEPARTMENT OF COMMERCE
Two Nationwide Plaza
Columbus, Ohio 43215

Telephone:
Area Code 614—466-3636

January 9, 1985

Mr. William W. Wiles
Secretary of the Board
Board of Governors of the
Federal Reserve System
20th Street and Constitution Avenue, N.W.
Washington, D.C. 20551

Dear Mr. Wiles:

The State of Ohio has received notification that pending before the Board are various applications which seek approval to create so-called "non-bank banks". These applications are recognized by the entire industry to be in opposition to the intent of the Bank Holding Company Act and the best interests of the various states and the dual banking system. Therefore, Ohio must oppose all such applications which are, or will be, before the Board for consideration, and, specifically, the applications which seek to locate such activities in Ohio.

I

Clearly, Ohio's statutory intention is to prohibit the types of institutions which would be created by the

approval of the pending applications. These are banks, chartered as such by the Comptroller and identified as such by the applicants, the industry and, if established, by the public. These banks are foreign subsidiaries of bank holding companies. Admittedly, these entities would be impermissible if the pending applications identified the very same subsidiaries as banks. Because the laws of Ohio do not specifically permit interstate banking, as necessitated by the Douglas Amendment, such subsidiaries are in violation of federal law. Similarly, two different sections of the Ohio Revised Code specifically prohibit foreign banks from conducting banking activities in Ohio, except for the lending of money and licensed trust activities. These two sections (attached herewith) clearly indicate that Ohio has not yet decided to permit interstate banking into the state.

In considering the timing of these applications, it is important for the Board to be aware that Ohio is currently considering if, and, if so, how, intertsate banking will be permitted within this state. It is anticipated that the legislation authorizing interstate banking will be reintroduced in this new legislative session, and such legislation may contain geographical limitations. Similar legislation was introduced late in the last session but the discussions had not run their full course. It is necessary that Oiho be given an opportunity to fully consider the very serious issues relating to interstate banking. Any approval of the pending applications would usurp these decisions from Ohio. Recognizing that Ohio has been approached to issue a state charter to an entity which is defined as a bank for state, but not federal, purposes, the understanding gathered from such an application process may well assist the legislature when

attempting to draft a bill regulating interstate banking. Ohio may not have the same discretion which the Board has in approving an application. This is primarily because the industry has long recognized that the Bank Holding Company Act was intended to prohibit this type of activity and Ohio, in addition to other states, relied on the federal statutes to aviod duplicity of regulation.

II

Ohio suggests that the benefits from the proposed activities do not outweigh the probable adverse effects. Because these types of applications, will be pursued only by large corporations, there will be a tendency to concentrate depository resources, something Ohio sta~~tutes~~ recognize as unacceptable. (See O.R.C. 1111.02) Furthermore, unfair competition will result because only institutions large enough to afford the application, capital requirements, and attendant expenses will apply for these non-bank banks. As a result, the deposits will be gathered ever increasingly by an ever decreasing number of institutions.

III

We are all hopeful that Congress will this year address the problems caused by "non-bank banks". Certainly, it was never intended that the 1970 amendment to Section 2(c) of the Bank Holding Company Act permit the establishment of interstate banking networks, thereby surreptitiously undermining the very Act of which it was a part. It would also be difficult to explain the concomitant usurpation of state's rights which are recognized by the Douglas Amendment. Ohio respectfully requests that the Board exercise its discretion and authority and pro-

hibit the expansion of the "non-bank bank" problem by denying the pending applications.

Respectfully submitted,

/s/ Linda K. Page
LINDA K. PAGE
Superintendent
Division of Banks

Enclosures

cc: Mr. Michael O'Rourke
Legal Division
Mail Stop 13

STATE OF TENNESSEE
DEPARTMENT OF FINANCIAL INSTITUTIONS
Second Floor, James K. Polk Building
505 Deaderick Street
Nashville, Tennessee 37219-5384
(815) 741-2236

W. C. ADAMS
Commissioner

January 3, 1985

Mr. Michael Bradfield
General Counsel
Federal Reserve System
Board of Governors
20th and Constitution, Northwest
Washington, D.C. 20551

Re: Application by Bank of Boston Corporation, Boston, Massachusetts to establish a national bank subsidiary pursuant to Section 4(c)(8) of the Bank Holding Company Act of 1956, as amended.

Dear Mr. Bradfield:

We have been advised by the Federal Reserve Bank of Boston that an application has been tendered by the Bank of Boston Corporation to establish a non-bank bank in Nashville, Tennessee. The purpose of this correspondence is to express our opposition to this application and other proposed applications to establish non-bank banks in Tennessee. We understand fully the liberal interpretation being applied to federal law allowing such banks to be established, however, we think it is contrary to the intent of the law and not in the best interest of Tennessee citizens. The Governor of Tennessee, the Legislature,

and the banking industry have all gone to great lengths to provide for an orderly progression for the Tennessee banking community into an interstate environment in accordance with the authority given the states in the Douglas Amendment to the Bank Holding Company Act of 1956, as amended. The Legislature has conducted hearings throughout the State to receive views of Tennessee citizens on the subject of interstate banking. Governor Lamar Alexander has appointed a Cabinet level committee to study in great detail the subject of interstate banking and its effect on interstate commerce, and as a result of that committee's work he has made certain recommendations and suggestions for new laws which would allow interstate banking in Tennessee. The banking industry has retained experts to conduct a study on interstate banking, and although there are different views maintained by Tennessee bankers, the Tennessee Bankers Association has arrived at a consensus for a regional interstate banking law being passed. All these events indicate that Tennessee is doing everything possible to provide for an orderly progression into the interstate banking environment. We feel this process was what was contemplated by Congress when they drafted the Douglas Amendment.

The proliferation of non-bank banks in Tennessee will make this process meaningless. To allow national banks to be established in Tennessee as non-bank subsidiaries of our-of-state bank holding companies circumvents the restrictions on interstate banking contained in the Bank Holding Company Act. Although Congress intended for each state to determine whether or not interstate banking should be allowed in their state, federal law is being interpreted to allow the Comptroller of the Currency to make that decision.

What is effectively happening is that through an interpretation of federal law, powers which were intended to be retained by the states are being usurped by an agency of federal government.

In 1983, Tennessee's Legislature passed a law as a result of a banking crisis which allowed for the establishment of industrial banks in Tennessee which could offer federally insured accounts. Although there was no intention by the Legislature to provide a means for out-of-state bank holding companies to establish such industrial banks, that was the result. Citicorp immediately applied to establish an industrial bank in Tennessee as a non-bank subsidiary of their bank holding company. Although the application to establish this industrial bank was criticized by the Fed, it was approved because there was no sound reason not to. However, Tennessee's Legislature had no intention to allow interstate banking at that time. In 1984 the Legislature repealed the law allowing for the establishment of industrial banks so that intertsate banking would come to Tennessee in an orderly manner, and not as an unintended result of a liberal interpretation of legislation passed for some other purpose.

Tennessee's citizens, including the Administration, the Legislature, and the banking industry as a whole have gone to great efforts to respond to the changing banking environment and economic needs of the State. They have done so through a well informed, thoughtful process. Such a process was contemplated by the United States Congress as evidenced in federal law in the Douglas Amendment. To allow for that authority to be usurped and the whole process thwarted by approving establishment of non-bank banks in Tennessee is an injustice and violation of

states' rights. We encourage the Federal Reserve Board not to approve this application or others to establish national bank non-banking subsidiaries in Tennessee.

We appreciate your full consideration of this matter.

Very truly yours,

/s/ W. C. Adams
W. C. ADAMS
Commissioner of Financial Institutions

WCA/sm

cc: Robert N. Brady
Assistant Vice President
Federal Reserve Bank of Boston
Boston, Massachusetts 02196

[SEAL]

STATE OF NEW JERSEY
DEPARTMENT OF BANKING
CN 040
Trenton, N.J. 08625

DOMINICK A. MAZZAGETTI
Acting Commissioner

May 15, 1984

Board of Governors
Federai Reserve System
21st and Constitution Ave., N.W.
Washington, D.C. 20551

Re: Interstate Consumer Bank Applications

Gentlemen:

By letters dated April 26, 1984, May 8, 1984 and May 11, 1984, we advised the Comptroller of the Currency of our objections to the following applications for national banks to be chartered within the State of New Jersey, but not subject to regulation as banks under the Bank Holding Company Act:

The Bank of New York, N.A., for a charter to be located in the vicinity of Mount Pleasant Avenue and Livingston Avenue, Livingston, Essex County, New Jersey;

Citibank (New Jersey, N.A.) for a charter to be located at 110 South Jefferson Road, Jefferson Plaza, Whippany, Morris County, New Jersey.

Marine Midland Bank (New Jersey, N.A.) for a charter to be located in Morristown, Morris County, New Jersey;

Irving Trust (New Jersey, N.A.) for a charter to be located in the vicinity of East Main and High Streets, Morristown, Morris County, New Jersey, and

Chase Manhattan Bank for a charter to be located in Hasbrouck Heights, New Jersey.

We hereby formally protest the applications of these institutions filed with the Board of Governors of the Federal Reserve and ask for the opportunity to be heard.

Very truly yours,

/s/ Dominick A. Mazzagetti
DOMINICK A. MAZZAGETTI
Acting Commissioner

☆ U. S. GOVERNMENT PRINTING OFFICE: 1985 461531 10159

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No. 84-1274

IN THE

Supreme Court of the United States

OCTOBER TERM, 1984

BOARD OF GOVERNORS OF THE
FEDERAL RESERVE SYSTEM

v.

DIMENSION FINANCIAL CORP., *et al.*

On Petition for Writ of Certiorari to the United States Court of Appeals for the Tenth Circuit

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JOINT BRIEF OF RESPONDENTS IN OPPOSITION

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STATEMENT OF CORPORATE AFFILIATIONS OF RESPONDENTS

The Respondents joining in this Brief in Opposition are:

Dimension Financial Corporation and members of its Board of Directors, Daniel T. Carroll, Harold D. Dufek, William L. Mitchell, Ronald L. Shaffer, and A. Gary Shilling. Dimension is a corporation that has applied to the Office of the Comptroller of the Currency for authorization to establish and operate thirty-one national banks in twenty-five states. Dimension is affiliated with Financial Investments Inc., a savings and loan service corporation and a wholly-owned subsidiary of Valley Federal Savings and Loan Association of Hutchins, Kansas;

American Financial Services Association, a national trade association of companies engaged in the consumer financial business;

Household Finance Corporation ("HFC"), which operates various financial institutions throughout the country, including numerous industrial banks and industrial loan corporations chartered in Colorado, Utah, Kansas, and Iowa, and which is a wholly-owned subsidiary of Household International, Inc.; First Bancorporation, a Utah bank holding company;

Colorado Industrial Bankers Association ("CIBA"), an association of industrial banks chartered in the state of Colorado;

Fort Lupton Industrial Bank, a subsidiary of Midwest Bancshares, Inc., Monroe Industrial Bank, an industrial bank owned by nine individual investors, Castle Rock Industrial Bank, a subsidiary of 405 Corporation, Ark Valley Industrial Bank, a subsidiary of 405 Corporation, Household Weld County Industrial Bank, Household Lamar Industrial Bank,

Household Alamosa Industrial Bank, Household Valley Industrial Bank, and Household Salida Industrial Bank, all of which are members of CIBA, and the last five of which are subsidiaries of HFC;

Financial Institutions Assurance Corporation, a state-regulated, private deposit insurer;

The State of Ohio and the Ohio Division of Savings and Loan Associations; and

The Ohio Deposit Guarantee Fund, Horizon Savings & Loan Association, Horizon Service Corporation, and Permanent Savings & Loan Association.

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IN THE

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BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM

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On Petition for Writ of Certiorari to the United States Court of Appeals for the Tenth Circuit

JOINT BRIEF OF RESPONDENTS IN OPPOSITION

STATEMENT OF THE CASE

In *Dimension Financial Corp. v. Board of Governors,* 744 F.2d 1402 (10th Cir. 1984), the court below invalidated an amended Board regulation that expanded the definition of "bank" and the Board's resultant jurisdiction under the Bank Holding Company Act of 1956 ("BHCA" or "Act"), 12 U.S.C. §§ 1841-1850 (1982).[1] Any company that is a "bank holding company" is subject to pervasive regulation by the Board under the BHCA.

[1] A recent order of the court of appeals clarified that its decision is limited to the portion of the regulation concerned with the "bank" definition. *See* Addendum A to the Documentary Supplement lodged with the Clerk of this Court. The Documentary Supplement contains materials referred to in this brief. Documents found in the administrative record of this case are cited here as "R. at ——, Addendum ——."

See BHCA §§ 3-4, 12 U.S.C. §§ 1842-1843. A "bank holding company" is "any company which has control over any bank." BHCA § 2(a)(1), 12 U.S.C. § 1841(a)(1). "Bank" is defined in pertinent part as "any institution . . . which (1) accepts deposits that the depositor has a legal right to withdraw on demand, and (2) engages in the business of making commercial loans." *Id.* § 2(c), 12 U.S.C. § 1841(c).

The original 1956 Act defined "bank" broadly to include "any national banking association or any State bank, savings bank, or trust company." Congress twice restricted the scope of the BHCA, and the Board's jurisdiction thereunder, by narrowing the definition of "bank" in the Act: first, in 1966, by excluding companies that do not accept deposits which the depositor has a legal right to withdraw on demand; and, second, in 1970, by excluding companies that do not engage in the business of making commercial loans.[2]

The matter at issue in this case is the December, 1983 decision of the Board to recast the two key provisions of the Act's definition of "bank." The Board amended its Regulation Y, which implements the BHCA, to define "deposits that the depositor has a legal right to withdraw on demand" as "any deposit with transactional capability that, *as a matter of practice*, is payable on demand . . . ." 12 C.F.R. § 225.2(a)(1)(ii)(A) (1984) (emphasis added).

The Board defined "commercial loan" to include a number of short-term investment vehicles that financial institutions have historically employed to make use of temporarily idle funds for the purpose of asset-liability management, including the purchase of retail installment loans or commercial paper, certificates of deposit, bankers' acceptances, the extension of broker call loans, the sale of federal funds and the deposit of interest-bearing funds. 12 C.F.R. § 225.2(a)(1)(ii)(B).[3]

The avowed purpose of these definitional changes was to extend the Act to reach so-called "nonbank banks"—institutions that were not previously subject to the Board's jurisdiction under the BHCA, because they did not engage in both of the activities identified in the two-pronged definition of "bank" in the Act. Such institutions either (i) offer NOW accounts with respect to which the depositor does not have a legal right to withdraw deposits on demand, or (ii) do not engage in the business of making commercial loans. *See* App. at 24a-25a. However, the effect of the new definitions was not limited to "nonbank banks." A number of other longstanding institutions, such as state-chartered and -insured savings and loan associations, would now be subject to the Act.[4]

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[2] *See* S. Rep. No. 1179, 89th Cong., 2d Sess. 7, *reprinted in* 1966 U.S. Code Cong. & Ad. News 2385, 2391 ("1966 Senate Report"); and S. Rep. No. 1084, 91st Cong., 2d Sess. 24, *reprinted in* 1970 U.S. Code Cong. & Ad. News 5519, 5541 ("1970 Senate Report").

[3] The new definitions in amended Regulation Y restated positions first announced by the Board in two 1982 rulings. The Board first announced its redefinition of "legal right" to mean "as a matter of practice" for purposes of BHCA § 2(c)(1) in its *First Bancorporation* decision, 68 Fed. Res. Bull. 253 (1982). The Board first announced that its definition of "commercial loans" included investment instruments like certificates of deposit in its December, 1982 "Dreyfus" letter to the Federal Deposit Insurance Corporation (FDIC). *See* Appendix to the Board's Petition for a Writ of Certiorari, 6a-7a. References to the Board's Petition are cited here "Petition at ——"; references to the Appendix to the Petition are cited "App. at ——."

[4] *See, e.g.*, Federal Reserve Press Release at 7 (December 29, 1983), R. at 1627, Addendum B (noting that "[u]nder the revised regulation" companies that own "savings and loan associations, the accounts of which are not insured by the Federal Savings and Loan Insurance Corporation and that offer NOW accounts and make commercial loans" must register as "bank holding companies" and "conform [their] activities to [the Act].").

The Board's new definitions were sharply criticized by other banking regulators, as well as by members of the financial community. The Office of the Comptroller of the Currency ("OCC") and the Federal Deposit Insurance Corporation ("FDIC") both asserted that the definitions had no statutory basis and emphasized that the definition of "bank" was a jurisdictional matter properly addressed only by Congress.[5]

Three Federal Reserve Banks also objected to the Board's definitions. The Federal Reserve Bank of Atlanta stated that "[s]ince the new definition of commercial loans has no basis in tradition or in the BHC Act it appears to provide an overly broad extension of the regulation." R. at 358, Addendum E. The Federal Reserve Bank of San Francisco agreed, noting that "we are not convinced that the Board's expansive reading of 'bank' is justified, or that Congress intended that so-called 'nonbank banks' be subject to Board authority under the Bank Holding Company Act." R. at 312, Addendum F. The Federal Reserve Bank of Chicago termed the Board's commercial loan definition "unduly restrictive." R. at 370, Addendum G.

The Board's isolation within the Government on this issue has only increased since the decision of the court below. The Department of the Treasury has indicated its belief that the court reached the right result. *See* Letter from Donald T. Regan, then Secretary of the Treasury, to A. J. King, President, Independent Bankers Association of America (Nov. 30, 1984), Addendum H ("[T]he chartering of nonbank banks is permitted under present law. This fact was supported most recently by the 10th Circuit's decision in *Dimension Financial Corporation v. Board of Governors of the Federal Reserve*

[5] *See* R. at 444, Addendum C (OCC Comment Letter); *id.* at 477, Addendum D (stating that the FDIC was "deeply concerned over the Board's attempt to resolve by regulation outstanding policy issues that are better left to Congress.").

System."). The Department of Justice has determined not to join the Board in this Petition for a Writ of Certiorari. The Solicitor General's Office merely authorized the Board to file on its own behalf, and the United States Government is thus not a party to the Board's petition. The Comptroller of the Currency, the primary regulator of national banks, was "strongly opposed to the filing of this petition." [6]

REASONS FOR DENYING THE PETITION

The issues in this case fundamentally pose legislative rather than judicial questions and are therefore inappropriate for Supreme Court review. Under the guise of statutory interpretation, the Board is attempting to resolve administratively the issues of what its jurisdiction under the BHCA *ought* to be and what the overall framework of federal banking regulation *ought* to be in light of changes the Board perceives in the financial marketplace. These are questions which necessarily involve legislative judgments concerning conditions in the current marketplace, political compromises among competing interests, and coordination of potential changes in the BHCA with other related banking regulatory statutes. The underlying character of the issues in this case, and the lack of merit in the Board's statutory interpretation, suggest that review of the lower court decision should be denied and that resolution of the policy

[6] Letter to Lawrence G. Wallace, Deputy Solicitor General, from Richard V. Fitzgerald, Chief Counsel, Office of the Comptroller of the Currency (February 5, 1985), Addendum I at 1. Earlier, the Comptroller's legal staff informed the Justice Department that "*certiorari* ought not to be sought" in this case and that the "limitations and restrictions" contained in Regulation Y "are unwarranted by applicable statute." Letter to Robert E. Kopp, Director, Appellate Staff, Civil Division, Department of Justice, from Eugene M. Katz, Assistant Director, Litigation Division, Office of the Comptroller of the Currency (November 30, 1984), Addendum J at 1. These letters were obtained through a Freedom of Information Act request.

issues raised by the Board should remain where they properly belong—in Congress.

1. As the Board notes, Congress has been considering and is currently considering the issue of the Board's jurisdiction. *See* Petition at 24 n.18. A comprehensive banking bill (S. 2851) that, among other things, would have changed the BHCA definition of bank passed the Senate last session but was not acted on by the House. Five bills have been introduced in the current session that address the structure of federal regulation of financial institutions, including the Board's jurisdiction under the BHCA.[7] The issue of the Board's jurisdiction is thus receiving active Congressional consideration, and Congress has the power to change the definition of "bank" if Congress deems fit.

2. Despite the Board's effort to justify the "bank" definition in terms of halting the expansion of so-called "nonbank banks" until Congress can act (*see* Petition at 23-24 & n.18), the reality is that, *with Board approval*, nonbank banks are continuing to be authorized despite the Board's new definition. Therefore, reversal of the lower court would not halt the expansion of "nonbank banks" which the Board now claims to fear, and will not measurably contribute to the Board's professed goal of giving Congress time to act.

The proliferation of nonbank bank applications that the Board so decries in its Petition stems in large part from the Board's own decision in *U.S. Trust Corporation*, 70 Fed. Res. Bull. 371 (1984), which the Board neglects to mention in its petition.[8] In that proceeding, the Board, acting on an application under section 6 of the BHCA, permitted a New York bank holding company to expand the activities of its existing nonbank subsidiary in Florida to include the acceptance of time and demand deposits

[7] S. 510, H.R. 15, H.R. 20, H.R. 428, and H.R. 1276.

[8] A petition for review is pending. Florida Bankers Ass'n v. Board of Governors, No. 84-3269 (11th Cir. filed Apr. 23, 1984).

(including checking accounts) and the making of consumer loans, but excluding the making of commercial loans as defined by the Board in its amended Regulation Y. The Board believed that approval of U.S. Trust's application "present[ed] a serious potential for undermining the policies of the Act," but pronounced itself "constrained by the definition of bank in the Act to approve the application." 70 Fed. Res. Bull. at 372. The Board's ruling came five months before the decision of the court of appeals below.

The Board's favorable action on U.S. Trust's application triggered a flurry of activity by other banking institutions already subject to the Board's jurisdiction under the BHCA, similarly seeking to broaden their multistate presence through the "consumer bank" approach. According to a tabulation compiled by the Comptroller of the Currency, between March 30, 1984 and October 30, 1984 (the latter date being approximately one month after the court of appeals decision below), the federal banking authorities had received 334 applications for authority to charter interstate "non-bank banks" or to expand trust company powers—all but 19 of them within 90 days after the Board's decision in *U.S. Trust.* Office of the Comptroller, "Summary of Non-Bank Bank Applications" (Nov. 1, 1984), Addendum K.

In a series of rulings following its *U.S. Trust* decision, the Board has continued to approve bank holding company applications to acquire or establish "nonbank banks" outside the States of their respective incorporation. In at least one such case, the Board has approved the application on the ground that the "nonbank banks" to be acquired will not accept demand deposits as the Board has defined that term in its amended Regulation Y.[9] In other such rulings, the Board has granted ap-

[9] Irving Bank Corporation, 71 Fed. Res. Bull. ——, ——, slip op. at 2 (Jan. 31, 1985).

proval on the ground that the "nonbank banks" to be acquired will refrain from making "commercial loans" as the Board has defined that term in the revised Regulation Y.[10] In each instance, the Board has pronounced itself "constrained by the technical definition of 'bank' in the Act" to arrive at its decision, and has expressed the need for congressional action to amend the statute.

In short, the "tide" of applications about which the Board expresses so much concern "[i]f the Tenth Circuit's decision is left intact" (*see* Petition at 22) has not been caused by the court decision below. Rather, those applications would continue even if the court below were reversed. The Board itself acknowledges that only Congress has the power to address the problem the Board perceives.

3. That the issue of what is a "bank" for the purposes of the BHCA is one properly resolved by Congress is further demonstrated by the disruption that the Board's new definition of this term would cause in the existing structure of banking regulation. The Board claims that the additional jurisdiction implicit in the new Regulation Y definition is necessary to avoid "chang[ing] the face of banking in the United States." Petition at 23. In reality, however, the Board's action disrupts a number of other statutory schemes and institutional relationships, distorting the structure of banking regulation that Congress has carefully constructed over the years.

While purportedly aimed at "nonbank banks," the Board's expansion of the term "bank" brings under the Act a number of institutions that have long existed with-

[10] Bankers Trust New York Corporation, 71 Fed. Res. Bull. 51 (1984); Suburban Bancorporation, 71 Fed. Res. Bull. 61 (1984); First National State Bancorporation, 71 Fed. Res. Bull. 115 (1984); Maryland National Corporation, 71 Fed. Res. Bull. —— (Feb. 4, 1985); Mellon National Corporation, 71 Fed. Res. Bull. —— (Feb. 13, 1985).

out being subject to the Act. Even the Board recognizes that its definition sweeps under the Act institutions that Congress did not intend to be subject to the Act's provisions.[11] The new Regulation Y attempts to cure this anomalous result by permitting such companies to "petition the Board for relief on grounds of hardship or unfairness." R. at 1627, Addendum B. But such "grandfathering" of institutions to exempt them from a statute's coverage is clearly a legislative activity and merely underscores the essentially legislative character of the Board's new regulation, as the court below noted. App. at 18a.[12]

Subjecting to the Act institutions not intended by Congress to be covered conflicts with existing statutory provisions. Perhaps the most dramatic example concerns the BHCA requirement that a "bank" subject to the Act must obtain FDIC insurance. BHCA § 3(e), 12 U.S.C. § 1842(e). The Board's new definition of "bank" transforms certain institutions, such as state-chartered savings and loans that are *ineligible* for FDIC insurance, into "banks." Remarkably, the Board "resolves" this dilemma by dictating to Congress a deadline in which to pass legislation ending the statutory conflict created by the Board's new definition:

> The Board notes that, under the Act, an institution that qualifies as a bank under the Board's interpretation and that is owned by a company would be al-

[11] As discussed *infra* at section 7, pp. 20-22, the Board's bank definition even brings back under the Act the particular institution, Boston Safe, that Congress specifically intended to exclude from the Act's coverage through the 1970 amendments.

[12] *See* In Re Surface Mining Regulation Litigation, 627 F.2d 1346, 1358-59 (D.C. Cir. 1980): "The law does not permit an agency to exercise powers expressly denied it by Congress if it includes a variance mechanism that perhaps will be used to bring the agency's regulations within the boundaries established by the statute."

lowed two years to obtain FDIC insurance. This will provide time for Congress to consider amending section 3(e) of the Act to allow other types of qualified insurance as an alternative to FDIC insurance. App. at 44a.

Another disruption caused by the Board's new definition affects the private deposit insurance system. As an alternative to FDIC or FSLIC insurance, many states permit state-regulated private deposit insurance corporations. This system has received Congressional recognition, for example, in the Garn-St Germain Depository Institutions Act of 1982, Pub. L. No. 97-320, 96 Stat. 1469. However, the Board's expansion of the definition of "bank" will force many of the institutions that currently use private deposit insurance to terminate such insurance and instead obtain FDIC or FSLIC insurance, thereby in effect forcing the "federalization" of the deposit insurance system. This interference with a state-created, congressionally approved system—part of the wider dual banking system approved by Congress [13]—belies the Board's professed wish to avoid "distorting the balance between state and federal bank regulations struck by Congress" (Petition at 23), as one of the reasons for its expanded definition of "bank." *See* App. at 8a.

While the Board argues that Regulation Y is intended to stabilize the nation's banking system (*see* Petition at 24-25), the court below correctly recognized the far-reaching effects of the Board's definition and the pervasive disruption of the status quo in the American financial community that it would engender:

> [The Board's definition] was to cause pervasive changes, thus to cause existing businesses to suddenly become bank holding companies and to necessitate reversal of acquisitions and to bring about divestitures; to chang the investments permitted of state chartered savings and loans; and to have other consequences on existing business. It affected other regulatory agencies. For example, the changes required federal deposit insurance for entities which had insurance under state funds and other funds. It required entities to obtain such insurance which were not eligible for it. In short, the changes in definitions and the jurisdiction of the Board would cause extensive changes by other agencies and of course by some entities providing financial services to the public. (App. at 5a).

[13] *See* S. Rep. No. 536, 97th Cong., 2d Sess., *reprinted in* 1982 U.S. Code Cong. & Ad. News 3054, 3069.

These far-reaching effects demonstrate that the Board's new definitions cannot be squared with the intent of Congress as a matter of statutory construction. For purposes of consideration of the Board's Petition, these effects also demonstrate the legislative nature of the issues created by the change in the Board's jurisdiction. Any change in that jurisdiction has a ripple effect on related laws and on existing institutions. Therefore, any such change should occur only through Congressional evaluation of the country's system of financial institution regulation.

4. Board statements acknowledge that its new and expanded definition of "bank" constituted a legislative response to a perceived need for a change in its jurisdiction to counted developments in the marketplace. In 1983, the Board proposed for introduction into Congress a bill that would have put a moratorium on any further developments in the banking system through broadening the definition of "bank" in the BHCA.[14] Board Chairman Volcker testified that "[w]e do think that the enactment of a temporary moratorium will give you [Congress] a

[14] The bill, S. 1532, defined "bank" as any institution insured by the FDIC. *See* Moratorium Legislation and Financial Institutions Deregulation: Hearings on S. 1532, S. 1609, and S. 1682 Before the Senate Comm. on Banking, Housing and Urban Affairs, 98th Cong., 1st Sess. 2 (1983) ("Moratorium Legislation Hearings").

little breathing room."[15] Congress did not enact the Board's requested moratorium, and Senator Garn, Chairman of the Senate Banking Committee, expressed disapproval of the Board's proposal.[16] Yet the Board subsequently justified its revision of Regulation Y as necessary to halt change in the financial marketplace "in order to avoid the preemption of Congressional discretion." App. at 61a. In effect, the Board has taken an action purportedly to provide Congress with "a little breathing room" that the Board—but not Congress—thinks Congress needs.

5. The final confirmation of the legislative and political nature of the Board's action is the isolation of the Board within the Government on this issue. As noted above, Congress refused the Board's request to broaden the definition of bank as a stop-gap measure.[17] The Board's fellow banking regulators—the OCC and the FDIC—have stated that the definition of "bank" and the delineation of the Board's powers are matters for Congress. The Treasury Department has indicated that broad-based legislation, not unilateral Board action, is the proper way to deal with developments in the marketplace. *See* Addendum H at 2. Even some of the Board's constituent Federal Reserve banks stated that the Board's definitions constituted "an overly broad extension of the regulation"

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[15] Moratorium Legislation Hearings at 140.

[16] *See id.* at 83 (remarks of Senator Garn). The Administration also opposed the Board's moratorium. *Id.* at 65 (testimony of then Secretary Regan).

[17] Several individual legislators have criticized the Board for appropriating a legislative function. For example, Senator Abdnor wrote the Board to question whether it was appropriate for the Board to promulgate rule changes while Congressional consideration was ongoing (R. at 500, Addendum L). *See also* R. at 521 (Representative Parris), at 525 (Representative Shumway), at 526 (Senator Simpson), at 529 (Senator Trible), at 530 (Representative Vento), and at 532 (Representative Dreier) (Addenda M-R).

and expressed doubt that "Congress intended [the] so-called 'nonbank banks' [to] be subject to Board authority under the Bank Holding Company Act." R. at 358, Addendum E; R. at 312, Addendum F.

As these other governmental entities recognize, the extent of the Board's jurisdiction and the shape of federal financial regulation are legislative issues properly resolved by Congress. These issues should therefore be left to Congress through a denial of the Board's petition.

6. In addition to appropriating legislative responsibility, the Board's definitions are invalid strictly as a matter of straightforward statutory interpretation, as held by the lower court. The lower court recognized the present action is a jurisdictional matter, exclusively involving questions of statutory interpretation. App. at 4a-5a. The court below correctly determined that the Board misconstrued both components of the BHCA's bank definition. The Board's definition of "deposits which the depositor has a legal right to withdraw" simply rewrites the statute, changing "legal right" to "as a matter of practice." The Board's definition of "commercial loans" conflicts with the plain meaning and Congressional intent behind the inclusion of the term in the BHCA.

a. The Board's admitted purpose in rewriting Congress' definition of "bank" under the BHCA was to enlarge the statutory net to reach financial institutions otherwise not subject to the Board's jurisdiction. Such entities now include industrial banks and industrial loan corporations that offer NOW accounts—that is, interest-bearing savings accounts, maintained by natural persons and nonprofit corporations, from which the customer may make withdrawals by negotiable draft as well as by personal presentation of his passbook. Typically, NOW account customers do not have the *legal right* to withdraw their NOW account deposits on demand. By law, institu-

tions that offer NOW accounts *must* reserve the right to require written notice before the customer withdraws his funds. This is true at both the federal and state levels.[18]

The "legal right" test for the "demand deposit" aspect of the BHCA's definition of "bank" has been on the statute books since 1966. But it was not until 1982 that the Board first declared that offering NOW accounts brings financial institutions within the Act's definition of "bank." In *First Bancorporation*, 68 Fed. Res. Bull. 253 (1982), a bank holding company organized under Utah law and controlling a state-chartered bank in Salt Lake City sought leave to acquire a Utah industrial loan company, Beehive Thrift & Loan. The Board conditionally approved First Bancorporation's acquisition, subject to a comprehensive array of restrictions predicated on the Board's conclusion that Beehive was a "bank" under the BHCA because it offered NOW accounts and made commercial loans.

In *First Bancorporation v. Board of Governors*, 728 F.2d 434 (10th Cir. 1984) (the "*Beehive*" decision), a panel of the court of appeals below set aside the Board's ruling. The court held that the Board could not lawfully treat Beehive as a "bank" for purposes of the BHCA because Beehive's NOW accounts were subject under Utah law to the industrial loan company's reservation of the right to require 30 days' notice from account holders prior to withdrawal. Far from "acknowledg[ing] . . . that

[18] The reserved right to require advance notice is a universal feature of NOW accounts. Federal law prohibits the payment of interest on demand deposits by Federal Reserve members, 12 U.S.C. § 371a (1982), and by FDIC-insured institutions, 12 U.S.C. § 1828(g). Federal law permits such institutions to pay interest on NOW accounts, 12 U.S.C. § 1832(a), but only because such accounts are subject to the reserved right to require notice of withdrawal. 12 C.F.R. §§ 217.1(e) & 329.1(e)(2) (1984).

Similarly, Respondents are aware of no state—and the Board has identified none—where financial institutions offer NOW accounts *without* reserving the right to require notice prior to withdrawal.

NOW accounts are, in operation, identical to checking accounts," as the Board now contends (Petition at 12), the court of appeals in *Beehive* came to the contrary conclusion:

> NOW accounts differ legally as well as in form from demand deposits. The substantive differences include that NOW accounts bear interest, are unavailable to certain depositors [principally corporations and for-profit business organizations], and cannot be subject to a legal right of withdrawal on demand under Utah law. (728 F.2d at 436).

The Board unsuccessfully applied to the court of appeals for rehearing of its *Beehive* decision, but sought no further judicial review.[19]

On petition for review of the Board's rulemaking order amending Regulation Y, the court below properly concluded that the challenge to the "demand deposit" prong of the Board's redefinition of "bank" presented no issues not previously considered in its *Beehive* decision. Petition at 4a, 18a. Accordingly, the court reaffirmed its prior analysis, rejecting the Board's purported expansion of the "bank" definition insofar as "demand deposits" were concerned.

b. The legislative history of the definition of "bank" in section 2(c) of the BHCA shows that when Congress used the phrase "legal right to withdraw on demand," it meant what it said. As originally enacted in 1956, the BHCA defined "bank" as "any national banking association, or any State bank, savings bank, or trust com-

[19] In its order adopting the revised definition of "bank" under Regulation Y, the Board concededly did no more than codify its *Beehive* decision, which at the time was pending on review before the court of appeals. The Board acknowledged that a reversal in *Beehive* would compel it to reconsider its revised "bank" definition under Regulation Y. 49 Fed. Reg. 798-99 (1984); R. at 1652, Addendum S. However, no such reconsideration was forthcoming following the court of appeals' *Beehive* decision.

pany. . . ." Act of May 9, 1956, ch. 240, § 2(c), 70 Stat. 133. Under that definition, the Board issued two controversial rulings in which it applied the Act to industrial banks. In "Applicability of the Bank Holding Company Act to Industrial Banks," 49 Fed. Res. Bull. 165 (1963), the Board acknowledged that the Act "was directed principally at control of 'commercial' banks," and that " 'industrial banks' . . . were not regarded as being engaged in commercial banking." *Id.* at 166. Nonetheless, the Board ruled that the acquisition of an industrial bank would be subject to the BHCA if "it accepts deposits subject to check or otherwise accepts funds from the public that are, *in actual practice, repaid on demand*, as are demand or savings deposits held by commercial banks." *Id.* at 166 (emphasis added).[20]

During hearings on proposed amendments to the BHCA in 1966, witnesses called upon Congress to overturn the Board's application of the Act to industrial banks. *Hearings on S. 2353, S. 2418, and H.R. 7371 Before a Subcomm. of the Senate Comm. on Banking and Currency*, 89th Cong., 2d Sess. 155-57, 394-95 (1966) (the "1966 Senate Hearings"). In a letter to the committee, the Board recognized a distinction between deposits that "in practice" are paid on demand and deposits that are truly "payable on demand." The Board also agreed that by redefining "a bank" as an institution that "accepts deposits payable on demand," the BHCA henceforth would exclude institutions that required notice before repaying deposits, even if in practice the institutions permitted withdrawals of such deposits "on demand." Letter of Board of Governors (April 20, 1966), 1966 Senate Hearings at 447.

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[20] Two years later the Board reaffirmed its position in "Industrial Banks as 'Banks' under Bank Holding Company Act," 51 Fed. Res. Bull. 1539-40 (1965). There the Board ruled that the Act applied to industrial banks issuing investment certificates that were "repaid, *in practice*, on demand." *Id.* at 1540 (emphasis added).

Congress went one step farther than the Board recommended. To ensure that an industrial bank that in practice repays deposits "on demand" without legal compulsion to do so is not a "bank" covered by the BHCA, Congress limited the definition of "bank" to "any institution that accepts deposits that the depositor has a *legal right* to withdraw on demand . . . ." Bank Holding Company Act Amendments of 1966, Pub. L. No. 89-485, § 3, 80 Stat. 236 (emphasis added). Congress thereby expanded on the Board's concession and overrode the Board's two prior rulings on the subject. Congress used the words "legal right to withdraw on demand" in section 2(c) to exclude institutions that reserve the right to require notice before allowing their customers to withdraw funds, even if *in practice* the institutions permit withdrawals on demand.

Congress also made it clear that industrial banks were to be beneficiaries of the new statutory language. The Senate Report accompanying the 1966 BHCA amendments explained that one pertinent objective of the legislation was to ensure that the Act did *not* cover industrial banks: "[T]he bill redefines 'bank' as an institution that accepts deposits payable on demand (checking accounts), the commonly accepted test of whether an institution is a commercial bank *so as to exclude institutions like industrial banks* . . . ." 1966 Senate Report, 1966 U.S. Code Cong. & Ad. News at 2391 (emphasis added). Senator Robertson said: "This definition clearly excludes industrial banks." 112 Cong. Rec. 12,388 (1966). The Board has conceded that the 1966 Amendments to the BHCA "were designed to exclude from coverage under the Act . . . industrial banks." App. at 24a.

In *Beehive*, the court of appeals correctly held that the legislative history of the "demand deposit" definition in the BHCA compelled rejection of the Board's approach:

> Congress rejected the Board's suggested amendment [in 1966 to the existing statutory language] which would have read merely 'payable on demand.' Con-

gress therefore overturned the Board's interpretation by substituting the *'legal right* to withdraw' language for the Board's right to withdraw on demand *in actual practice* provision. That differentiation, in the words of the Senate Banking Committee chairman, 'clearly excludes industrial banks.' . . . No room exists for an argument that a practice as to NOW accounts should prevail rather than the statute. (728 F.2d at 436-37) (emphasis in original).[21]

c. The Board's revised definition of "demand deposits" runs counter to the Board's own regulations. The Board has distinguished interest-bearing savings accounts from demand deposits in two of the most important regulatory schemes promulgated and administered by the agency—its Regulations D and Q, which impose, respectively, reserve requirements and interest-rate limitations on deposits in covered depository institutions. 12 C.F.R.

[21] The Board contends that the legislative history of the 1966 amendment somehow supports its revision of Regulation Y, evidently on the theory that Congress considered the use of check-like instruments of withdrawal to be the litmus test for "banks" under the Act. Petition at 11-12 & n.6. But the legislative record is devoid of evidence that Congress had any such idea in mind when it redefined "bank" to exclude institutions where customers had the ability *in practice* to withdraw funds on demand, without the *legal right* to do so. The Congressional objective in amending § 2(c) in 1966 was not to establish a particular instrument of withdrawal as the talisman for determining whether an institution is a "bank." Rather, Congress repudiated the Board's earlier decisions that the Act encompassed industrial banks that "in practice" allowed customers to withdraw deposits on demand—decisions that did not turn on the type of instrument used to effect withdrawals.

Thus, Congress established that an institution reserving the right to require notice before paying *any* instrument of withdrawal—be it check, draft, or withdrawal slip—could not be deemed a "bank" under the Act. If Congress had intended to base the statutory test in § 2(c) on the available means of withdrawal, rather than on the customer's *legal right* to withdraw on demand, it easily could have defined "banks" in terms of deposits from which withdrawals may be made by negotiable instruments, as the Board now attempts to do by administrative fiat. Congress did not do so.

§§ 204, 217 (1983). In recent years, the Board has amended Regulations D and Q to provide for NOW accounts. In both regulatory schemes, the Board has declined to classify NOW accounts as "demand deposits." Instead, it has given express legal effect to the reserved right to require notice of withdrawal in treating NOW accounts as *savings* deposits. 12 C.F.R. §§ 204.2(b)(1) & (d)(1) (1984) (Regulation D); *id.* § 217.1(e)(3) (1984) (Regulation Q).[22]

d. The Board's reliance upon *Wilshire Oil Co. v. Board of Governors*, 668 F.2d 732 (3d Cir. 1981), *cert. denied*, 457 U.S. 1132 (1982), is misplaced. There a bank holding company already in control of a commercial bank sought to evade the Board's jurisdiction by causing its bank subsidiary, the Trust Company of New Jersey, to advise customers holding non-interest-bearing demand deposits (*i.e.*, traditional checking accounts) that henceforth the Trust Company would reserve the right to require prior notice of withdrawal, but that it had "no intention of exercising" that right. 668 F.2d at 733-34. By this transparent device, the Trust Company sought to convert its conventional checking accounts into something other than "demand deposits." Its objective was to evade the coverage of the BHCA, so that its corporate parent could continue to engage in the oil business, an activity impermissible for a bank holding company.

The Board concluded that the Trust Company should be treated as a "bank" under the Act, because the Trust Company remained "an institution that accepts checking accounts, including those of business organizations."

[22] Even under the BHCA, prior to the abrupt policy reversal in *First Bancorporation*, the Board consistently ruled that financial institutions offering NOW accounts and making commercial loans were not "banks" under the Act because NOW accounts are not demand deposits. *See, e.g.*, First Financial Group of New Hampshire, Inc., 66 Fed. Res. Bull. 594, 594 (1980); Heritage Banks, Inc., 66 Fed. Res. Bull. 917 (1980).

Wilshire Oil Co., No. 1114026, slip op. at 16 (Apr. 2, 1981). The Board further ruled that the sole purpose of the Trust Company's purported notice had been to evade the strictures of the Act. *Id.* at 18.[23]

The Court of Appeals for the Third Circuit affirmed on the ground that the Board properly had found that the Trust Company's purported reservation of the right to require advance notice of withdrawals from its checking accounts had no effect on its existing status as a "bank" under the BHCA. 668 F.2d at 740. The court of appeals noted that even after its notice to depositors, the Trust Company continued to refer to its deposits as "demand deposits," *id.* at 738 n.11; that the accounts at issue were non-interest-bearing, *id.* at 737 n.8; and that federal law restricted NOW accounts (which bear interest) to individuals and nonprofit corporations—a restriction not adopted by the Trust Company. *Id.*

The court of appeals in *Wilshire* did not suggest that financial institutions such as industrial banks or savings and loan associations could be brought wholesale within the BHCA by equating NOW accounts with demand deposits, or that regulation of all such institutions was necessary to prevent "evasions" of the Act. Thus, there is no conflict between the Tenth Circuit's decision and the *Wilshire* holding. *See Beehive*, 728 F.2d at 436.

7. a. The "commercial loan" component of the Board's new Regulation Y contradicts the Congressional intent behind the 1970 BHCA amendments, which inserted the provision into the definition of "bank" in order to re-

[23] As the Board recently told the Court of Appeals in the Eleventh Circuit, *Wilshire* is a case "where a financial institution whose activities *already satisfied the definition of 'bank'* sought to place itself outside of the [BHC] Act's coverage without altering any of the banking activities actually performed by the bank." Brief for Board at 28, Florida Bankers Ass'n v. Board of Governors, No. 84-3269 (11th Cir. Sept. 24, 1984) (emphasis added).

strict the Act's coverage to those entities which genuinely implicate the underlying purposes of the Act. As noted, the purposes of the BHCA are "to restrain undue concentration of *commercial* banking resources and to prevent possible abuses related to the control of *commercial* credit." 1970 Senate Report, 1970 U.S. Code Cong. & Ad. News at 5541 (emphasis added). The Board's revised Regulation Y, however, redefines so broadly the "commercial loan" component of the BHCA's definition of "bank" that it sweeps into the scope of the BHCA financial institutions which do not engage in traditional commercial lending and, accordingly, do not implicate the underlying purposes of the BHCA. In short, the Board has used the "commercial loan" component, a provision intended to restrict the scope of the BHCA and limit the Board's jurisdiction, to expand the BHCA's coverage and thus broaden the Board's authority. Neither result was intended by Congress.

The clearest demonstration that the new Regulation Y over-extends the scope of the BHCA is that it subjects to the BHCA institutions like Boston Safe Deposit & Trust Co. ("Boston Safe"), institutions that Congress expressly intended to exclude from the Act's coverage through the 1970 amendment. The legislative history of the BHCA demonstrates that Congress meant to exclude from the statute institutions which, like Boston Safe, made no commercial loans. 116 Cong. Rec. 25,848 (1970). As the Senate Report accompanying the 1970 amendment explains, the earlier 1966 amendments were "designed to include commercial banks and exclude those institutions not engaged in commercial banking." 1970 Senate Report, 1970 U.S. Code Cong. & Ad. News at 5541.[24] To realize

[24] Indeed, according to the 1970 Senate Report, the Board itself recognized that the BHCA's earlier definitions of "bank" were too broad and might "include institutions which are not in fact engaged in the business of commercial banking in that they do not make commercial loans." *Id.*

this goal fully, Congress in 1970 adopted the "commercial loan" component of the BHCA's definition of "bank," to exclude institutions that are not engaged in the business of making commercial loans from the definition of 'bank.'" *Id.* Congress expressly cited Boston Safe as an example of the kind of institution which should be excluded from the BHCA's coverage, because it made no commercial loans.[25]

Therefore, one thing is manifest from the legislative history of the 1970 amendment—"commercial loans" did not include the kind of activities engaged in by institutions like Boston Safe. In 1970, Boston Safe purchased commercial paper, certificates of deposit and bankers' acceptances and sold federal funds. R. at 921B, Addendum T. In 1972, the Board confirmed that these transactions did not constitute making commercial loans for purposes of the amended BHCA. R. at 1014R, Addendum U.

The Board's new Regulation Y, however, sweeps back into the BHCA institutions like Boston Safe, the very institutions Congress exempted in 1970. Because Regulation Y nullifies this central, restrictive purpose of the 1970 legislative action, the Board's interpretation is invalid as a matter of legislative interpretation. That the Board now would include under the BHCA institutions which Congress explicitly excluded is the clearest indication that the new Regulation Y contradicts the Congressional intent behind the 1970 BHCA amendments.

b. Contrary to the Board's assertion, Congress understood the plain meaning of "commercial loan" in 1970 and had definite purposes for including the term in the

[25] 116 Cong. Rec. 25,848 (1970). There is no indication that Congress intended to exclude only Boston Safe or only trust companies from the BHCA's coverage. Rather, Congress intended to exempt any institutions that "are not in fact engaged in the business of commercial banking in that they do not make commercial loans." 1970 Senate Report, 1970 U.S. Code Cong. & Ad. News at 5541.

BHCA. Commercial loans typically involve a direct extension of credit by a commercial bank to a non-banking enterprise for an extended period at an interest rate negotiated by the parties.[26] Such close lender-borrower relations may pose potential problems of improper credit tying and discriminatory credit favoritism. Thus, commercial loans were understood by Congress to be those active forms of lending that posed the potential for abuse that the BHCA was intended to prevent.[27]

The nation's financial institutions have historically dealt in other, passive investment vehicles, termed interbank and "money market" instruments, which have never been considered commercial loans. These money market instruments, typically used by financial institutions to invest temporarily idle funds on a short-term basis, involve no close lender-borrower relationship and so lack the potential for abuse that the BHCA was intended to prevent. Yet, although money market instruments are distinguishable from commercial loans and do not pose the potential for abuse that underlies the BHCA, they are precisely the instruments the Board's new Regulation Y now labels "commercial loans."[28]

[26] A bank loan to an enterprise to build a new manufacturing facility or to fund inventory is an example of a typical commercial loan, as historically defined.

[27] 1970 Senate Report, 1970 U.S. Code Cong. & Ad. News at 5541. Indeed, if Congress had wished to extend the BHCA's scope to all institutions that engage in transactions that "establish a debtor-creditor relationship and constitute an extension of credit or loan," as the Board now interprets the BHCA (App. at 46a), it could easily have done so. The fact that Congress chose the narrower "commercial loan" formulation demonstrates further the kinds of investments Congress meant to exclude and the restrictive scope Congress intended for the BHCA.

[28] Included in Regulation Y's redefinition of "commercial loan" are certificates of deposit, commercial paper, bankers' acceptances, broker call loans and sales of federal funds. A bankers' acceptance

The Board and its staff have consistently held that each of the money market instruments now captured by Regulation Y does not constitute commercial lending as defined by the BHCA. As noted, the Board in 1972 determined that Boston Safe's transactions in commercial paper, certificates of deposit, bankers' acceptances and federal funds did not constitute commercial lending for purposes of the BHCA. *See supra* at 22. In 1976 the Board staff determined that broker call loans did not constitute commercial loans.[29] In 1980, the Board's legal division held that the purchase of the guaranteed portions of Small Business Administration and Farmers Home Administration loans through nonbank dealers on the secondary market did not constitute commercial lending.[30] This consistent line of construction was summarized by the Board's staff in an internal 1981 memorandum which concluded that the purchase of federal funds

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is a time draft drawn on and accepted by a financial institution. Freund, Investment Fundamentals 188 (1983) (American Banking Association publication). Like commercial paper, bankers' acceptances are short-term, non-interest-bearing notes sold at a discount and redeemed at face value. Stigum, The Money Market 40 (rev. ed. 1983). Broker call loans are loans made to securities brokers and dealers on a day-to-day basis. Freund at 185. Federal funds transactions involve sales, often on an overnight basis, to another bank of reserves on deposit with the Board that are in excess of the selling bank's reserve requirements. *Id.* at 39.

[29] R. at 1014Y-Z, Addendum V. The Board's attorneys concluded that such money market transactions were a passive medium of investment and did

> not appear to have the close lender-borrower relationship that is one of the characteristics of commercial loans and which *presents the possibility of abuses relating to the control of commercial credit that concerned the Congress in adopting the commercial lending test.* (*Id.* (emphasis added)).

[30] R. at 1014CC, Addendum W. Like broker call loans, these investments did not present the danger for abuse of commercial credit to which the BHCA was directed. *Id.*

and money market instruments did not constitute commercial loans, nor were broker call loans or sold securities transactions considered commercial loans for purposes of the BHCA.[31]

Thus, for more than a decade following the 1970 amendments to the BHCA, the Board and its staff distinguished commercial loans from the passive investment vehicles now included in the new Regulation Y definition. Only in 1982, with its "Dreyfus Letter," followed in 1983 with the release of the Regulation Y amendments, did the Board abruptly change course. In extending the definition of commercial loan to cover money market instruments, the Board has therefore contradicted its own consistent interpretations, as well as the historic understanding of the term "commercial loan" in the financial industry.[32] Most important, the Board also nullified the distinction between commercial loans and other forms of investment which was the basis for the 1970 BHCA amendments.

Changes in American banking since the enactment of the BHCA have not altered the investment practices of

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[31] R. at 1014V, Addendum X. Here again, the Board's staff had no trouble distinguishing these passive investments that "did not involve the particular type of lender-borrower relationship that is one of the characteristics of commercial loan[s] . . . ." *Id.*

[32] Contrary to its assertion (Petition at 19 n.13), the Board's reversal of its long-standing interpretation of commercial loan is not a simple change of agency policy. Instead, by redefining the commercial loan provision, the Board has reconstructed the statute to extend the Board's jurisdiction beyond the bounds intended by Congress. The Board cannot expand its jurisdiction by such a device. Moreover, the Board's only complete public explanation for the revisions to Regulation Y's bank definition was contained in an Appendix released with the final draft of the revised regulation. Thus, affected parties were precluded from giving their comments on the Board's alleged rationale for the revisions. No explanation can be considered "adequate" when it is kept from the public until the time for comment is past.

institutions like Boston Safe so as to suddenly make them "banks" for purposes of the BHCA. Nor has it affected the essential differences recognized by Congress in the 1970 BHCA amendments between commercial loans and other forms of investment. All that has changed is the Board's definition of "commercial loan," as a device to expand the Board's jurisdiction over the nation's financial industry.

If, as the Board asserts, the evolution in the form and function of the nation's banking structure has somehow "outdated" the BHCA, then Congress must be the institution to recast the scope of the BHCA and the extent of the Board's jurisdiction thereunder. Although the Board may be impatient with the pace of this activity, any perceived delay merely reflects the absence of a consensus about what action, if any, is now required, and moreover suggests that the Board's views have not gained wide acceptance. In no event do such circumstances justify the Board's unilateral rewriting of the terms of a statute and resulting expansion of its jurisdiction, particularly when the Board's action contradicts the plain and historically accepted meaning of the statute's terms and the intent of Congress.

CONCLUSION

The court of appeals correctly held that the Board's definition of "bank" in the amended Regulation Y was improper. The underlying issues of the Board's jurisdiction and the overall framework of federal banking regulation are under consideration in Congress, where they properly belong. Accordingly, the Petition for Writ of Certiorari should be denied.

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No. 84-1274

In the Supreme Court of the United States

OCTOBER TERM, 1984

BOARD OF GOVERNORS OF THE
FEDERAL RESERVE SYSTEM, PETITIONER

v.

DIMENSION FINANCIAL CORPORATION, ET AL.

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE TENTH CIRCUIT

REPLY BRIEF FOR THE PETITIONER

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REPLY BRIEF FOR THE PETITIONER

I. THE COURT OF APPEALS' DECISION WILL HAVE A FUNDAMENTAL IMPACT ON THE NATION'S FINANCIAL SYSTEM

1. As shown in the petition, this case should be reviewed by the Court because the court of appeals' invalidation of the Board's regulatory definitions of "demand deposits" and "commercial loans" as used in the definition of "bank" in the Bank Holding Company Act of 1956 (BHCA or Act), 12 U.S.C. 1841 *et seq.*, will have a fundamental and far-reaching impact on the basic structure of the nation's financial system. As the petition explains (at 22-24), the Board's definitions are designed to restrain the

growth of the nonbank bank device as a method of evading the regulatory restrictions of the BHCA aimed at maintaining banks as impartial providers of credit and at preventing conflicts of interest, concentration of resources, unfair competition, and unsound banking practices. The nonbank bank loophole permits a fundamental restructuring of the banking industry by allowing the unrestricted combination of banking organizations with firms engaged in nonbanking activities of all kinds as well as the unfettered growth of interstate networks of banks—all without congressional approval. This development, which is proceeding apace, has included the widespread acquisition of banks by securities underwriters and dealers, despite this Court's concerns about preventing conflicts of interest and other unsound practices that can result when banks and the securities business are combined.[1] Unless these widespread developments are contained, the nation's financial system will be adversely affected by the breaching of the prudential barriers [redacted] separating banking and commerce. Federal Reserve Board Chairman Volcker summed up the Board's concerns about the effects of nonbank banks on the financial system:

> The consequences are obvious and serious. * * * The pervading atmosphere of unfairness, of constant stretching and testing of the limits of law and regulation and of circumvention of their intent, and of regulatory disarray is inherently troublesome and basically unhealthy.

Moratorium Legislation and Financial Institutions Deregulation: Hearings on S. 1532, S. 1609 and S.

[1] See *Securities Industry Ass'n* v. *Board of Governors*, No. 82-1766 (June 28, 1984), slip op. 6-10; see also *Investment Co. Institute* v. *Camp*, 401 U.S. 617, 629-634 (1971).

1682 Before the Senate Comm. on Banking, Housing, and Urban Affairs, 98th Cong., 1st Sess. 146-147 (1983) (testimony of Board Chairman Volcker).

a. Respondents do not deny that the nonbank bank device will have a significant impact on the nation's financial system but attempt to show that the Board's definitions are the cause of the disruption. These attempts are wholly without merit. Respondents err in asserting that the Board's definitions, by treating certain privately insured savings and loan associations that offer banking services as "banks" under the Act and thus requiring them to obtain federal deposit insurance, will wrongfully undermine the private deposit insurance system. The Board's definitions require federal deposit insurance for certain state-chartered savings and loan associations that are owned by companies and that are insured by private corporations only if the associations choose to exercise recently-granted, broad new powers that are functionally equivalent to the powers of a commercial bank. In 1982, Congress expressly excluded *federally insured* state-charted savings and loan associations, which have the same powers as their privately insured counterparts, from the BHCA's definition of bank. Pub. L. No. 97-320, § 333, 96 Stat. 1504. This exclusion implicitly recognized that these savings institutions may now exercise powers that, but for the exemption, would make them "banks" under the BHCA. See S. Rep. 97-536, 97th Cong., 2d Sess. 55 (1982). Pointedly, the amendment excluding savings and loan associations from the BHCA did *not* extend to *privately insured* institutions. The inference is inescapable that Congress viewed these privately insured associations as "banks" under the Act if they exercise their broad new powers without obtaining federal deposit insurance.

Indeed, dramatic evidence of the problems affecting the financial system that can result from nonbank banks that offer banking services without the safeguards provided by the BHCA, in particular the BHCA's requirement of federal deposit insurance for all banks owned by companies (12 U.S.C. 1842(e)), is the recent bank holiday ordered by the Governor of Ohio temporarily closing all institutions insured by respondent Ohio Deposit Guarantee Fund (ODGF). The temporary closing was ordered in the wake of multimillion dollar runs by depositors on several ODGF insured institutions after the March 9 closing of a Cincinnati savings and loan association insured by the Ohio fund.[2]

b. Moreover, the Board's reluctant approval of the acquisition of several nonbank banks by bank holding companies (Br. in Opp. 6-8) demonstrates the importance of the decision below. Each nonbank bank whose acquisition has been approved by the Board has voluntarily agreed not to offer demand deposits as defined in the challenged regulation, or not to make commercial loans as defined by the Board. In addition, the Board has imposed conditions prohibiting the joint operation of the nonbank bank and affiliated companies, in order to effectuate, at least for bank holding companies, the objectives of the Act.[3] These

[2] N.Y. Times, Mar. 16, 1985, at 1, col. 1; Wash. Post, Mar. 16, 1985, at 1, col. 1. The failure of the Cincinnati institution reportedly could exhaust the private ODGF's entire assets, prompting the State of Ohio to enact emergency legislation to create a new state funded and directed insurance fund for other thrift institutions insured by ODGF. Wall St. J., Mar. 14, 1985, at 8, col. 1; *id.* Mar. 12, 1985, at 3, col. 2; Am. Banker, Mar. 13, 1985, at 1, col. 4.

[3] See *e.g., U.S. Trust Corp.*, 70 Fed. Res. Bull. 371, 372 (1984) (nonbank bank will not make commercial loans as de-

restrictions on the operations of nonbank banks prevent these institutions from offering checking account and commercial lending services that are functionally equivalent to the services offered by banks covered by the Act. The Board's definitions thus represent a tangible and realistic deterrent to the growth of the nonbank bank as a device to circumvent the BHCA, although the definitions have not (and cannot without legislation) close the nonbank bank loophole entirely. Unless the decision of the court of appeals is reversed, the economic benefit of owning a depository institution that can provide all of the essential services of banking without being subject to the Act will become virtually irresistible and nonbank banks will be a significant, permanent feature of the nation's financial system.

In any event, the Board's approval of nonbank bank acquisitions shows conclusively that the Board has not usurped any legislative function. Each of the Board's approval orders expressly recognizes that legislation is necessary to extend the BHCA to all nonbank banks and that an institution that in reality does not accept demand deposits or does not make commercial loans is not a bank under the Act as currently written.[4] *E.g., U.S. Trust Corp.*, 70 Fed. Res. Bull. 371, 373 (1984).

fined in Regulation Y); *Irving Bank Corp.*, 71 Fed. Res. Bull. 173, 173-174 (1985) (nonbank banks will not accept demand deposits as defined in Regulation Y).

[4] The moratorium legislation supported by the Board would have in effect temporarily amended the definition of "bank" in the BHCA to cover any institution insured by the FDIC (Br. in Opp. 11-12). As demonstrated by the Board's orders approving nonbank bank acquisitions, the Board has not treated all insured bank as "banks" for BHCA purposes and thus has not attempted to accomplish administratively what Congress has declined to do by legislation.

2. Contrary to respondents' assertions (Br. in Opp. 6), there is no reliable evidence that legislation dealing with the growth of nonbank banks will receive congressional attention in the near future. Bills to close the nonbank bank loophole have been introduced since at least 1983 and, despite virtually uniform agreement among legislators that the loophole should be closed, none of these bills has been enacted. Indeed, some banking law commentators have suggested that legislation extending coverage of the BHCA to nonbank banks will not be adopted until 1986, if at all, or perhaps not even until the 100th Congress (beginning in 1987), due in part to the emergence of other developments in the banking industry also in need of legislative attention.[5] Given their importance for the nation's financial system, the issues raised by the court of appeals' decision should be resolved now and not by exploitation of loopholes.

II. THE BOARD'S DEFINITIONS ARE LAWFUL UNDER THE BHCA

1. With respect to the Board's definition of "demand deposits" to include Negotiable Order of Withdrawal (NOW) checking accounts, the petition demonstrates that the legislative history of the Act is replete with references describing demand deposits as checking accounts and that, notwithstanding a never-exercised prior notice of withdrawal requirement applicable to NOW accounts, these accounts are checking accounts that operate in the same manner as conventional demand checking deposits (Pet. 10-15).

Respondents' contentions concerning the inclusion of NOW accounts in the Board's definition of "demand deposits" are at odds with the statutory language, distort the legislative history, and ignore the fact that in actual operation NOW accounts are substantively indistinguishable from conventional demand deposits. Section 2(c) of the BHCA, 12 U.S.C. 1841(c), refers to deposits that the depositor "has a legal right to withdraw on demand." As the Board has recognized,[6] a NOW account depositor in effect has a legal right to withdraw funds from the account by check on demand until the depository institution actually requires prior notice of withdrawal, a requirement that with respect to NOW accounts, has not been and cannot ever practically be invoked (see Pet. 12-13 & n.7).

[5] Hawke, *Nonbank Banks Should Get Down to Business*, Am. Banker, Nov. 15, 1984, at 4, col. 1.

Contrary to respondents' claim (Br. in Opp. 15-18), the legislative history of the 1966 amendment to the BHCA incorporating the demand deposit test into the Act's definition of "bank" demonstrates that the ability to make withdrawals by check was viewed as the determinative factor of "demand deposits" as used in the amendment. The Board's 1963 interpretation concerning institutions that would be "banks" as defined in the Act as originally enacted distinguished between two categories of deposits based, not on the existence of a notice of withdrawal requirement, but on the method by which withdrawals could be made: deposits "subject to check" or deposits not subject to check but that "otherwise * * * in actual practice [are] repaid in demand." 49 Fed. Res. Bull. 166 (1963). NOW accounts would clearly have fallen in the first category of deposits, *i.e.*, deposits subject to check.[7]

[6] *First Bancorporation (Beehive Thrift & Loan)*. 68 Fed. Res. Bull. 253, 253 (1982).

[7] Respondents' reading of the legislative history is apparently premised on the unsupported assumption that the 1963

In 1966, the Board endorsed legislation to amend the definition of "bank" to cover only an institution that receives deposits "payable on demand." The Board stated that this proposal would cover institutions "that offer checking accounts" and exclude institutions that accept deposits that are paid on demand. *Amend the Bank Holding Company Act of 1956: Hearings on S. 2353, S. 2418 and H.R. 7371 Before a Subcomm. of the Senate Comm. on Banking and Currency*, 89th Cong., 2d. Sess. 447 (1966) [hereinafter cited as *1966 Hearings*]. This proposal was plainly meant to continue coverage of the deposits in the first category described in the Board's 1963 interpretation (deposits subject to check) and to exclude from coverage deposits in the second category—*e.g.*, passbook and statement savings accounts.

The Board's proposal was in substance enacted. Although the language in the bill reported by the Senate Banking Committee (and later enacted) referred to covered deposits in terms of a legal right to withdraw on demand, the Committee's report explained this language as covering deposits "payable on demand (checking accounts)," precisely the terminology the Board had proposed.[8] S. Rep. 1179, 89th Cong., 2d Sess. 7 (1966).

interpretation distinguished between the two classes of deposits on the basis of whether the institution reserved the right to require advance notice of withdrawal from the deposit. However, nothing in the Board's 1963 interpretation (or in the subsequent history) specifically mentions a prior notice of withdrawal requirement.

[8] The fact that the 1966 amendment was intended to exclude industrial banking organizations from coverage as "banks" under the Act does not support respondents' contentions. In seeking the exclusion of industrial banking organizations from the Act, industry representatives expressly ad-

Respondents do not contest the fact that NOW accounts are checking accounts and in reality are used for the same purposes and in the same manner as conventional demand deposits. The fact, relied on by respondents, that NOW accounts generally bear interest and are not available to all depositors does not prevent these accounts from being used as a device to circumvent coverage of the BHCA. By offering NOW accounts in place of conventional demand deposits, nonbank banks will be able to provide in practice exactly the same checking account and commercial lending services provided by many commercial banks subject to the BHCA. According to data compiled by the Board, many smaller commercial banks now covered by the BHCA provide essentially consumer-oriented services and as a result hold only a small proportion of their deposits in non-interest-bearing, business checking accounts.[9] Thus, the offering of non-interest-bearing accounts to businesses is not a critical aspect of the banking functions intended to be covered by the Act.[10]

vised Congress that these institutions "make direct loans * * * to *consumers*" and "*do not accept checking accounts.*" *1966 Hearings* 155, 157 (emphasis added). Today, however, many industrial banks offer precisely these services.

[9] At about 1900 commercial banks (excluding nonbank banks), which is more than ten percent of all commercial banks in the country, the total amount of conventional demand deposits is less than ten percent of assets. According to statistics maintained by the Board, the amount of conventional demand deposits held by businesses typically constitutes about half of total demand deposits.

[10] Equally misplaced is respondents' reliance on the current definitions of "demand deposit" in the Board's Regulations D and Q, which relate, respectively, to the maintenance of reserves and to maximum interest rates payable on deposits by

2. The Board has also shown that the BHCA does not define the term "commercial loans," that this term is not explained in the legislative history, and that each money market instrument included in the Board's definition can reasonably be viewed as a loan to a commercial enterprise (Pet. 15-19). Respondents do not contest the Board's findings on the economic characteristics of the money market instruments included in the definition of "commercial loans," but assert that Congress meant that term to include only commercial loans as traditionally defined, *i.e.*, loans to a nonbanking enterprise that involve direct negotiations between the borrower and lender (Br. in Opp. 22-23). This test is inconsistent, however, with traditional practices in the banking industry, as well as with the purposes and legislative history of the BHCA.

A bank's purchase in the open market of commercial paper, a money market instrument included within the Board's definition of "commercial loans," traditionally has been considered to be the making of a commercial loan by the purchasing bank. Indeed, both today and in 1970, when the "commercial loans" test was added to the BHCA, commercial paper purchased by a bank in the open market is uniformly

depository institutions. 12 C.F.R. Pts. 204, 217. At the time the demand deposit test was added to the BHCA, the definitions in the Board's Regulations D and Q contained provisions prohibiting withdrawals by check from savings accounts and NOW account thus would have been considered demand deposits. See 26 Fed. Reg. 12031 (1961). Moreover, regardless of the technical classification of NOW accounts for purposes of the definitions in Regulations D and Q, NOW accounts are treated substantively far differently than ordinary savings accounts. Depository institutions offering NOW accounts must maintain the same level of reserves with respect to NOW accounts as are maintained with respect to conventional demand deposits. 12 C.F.R. 204.2(e), 204.8.

reported in banks' published balance sheets in the category of "commercial and industrial loans." [11] Respondent's theory would preclude even this type of traditional, open market commercial lending vehicle from being treated as a commercial loan for purposes of the BHCA's definition of "bank." [12]

In addition, respondents' proposed test of "commercial loans" is not consistent with the purposes for which Congress enacted the BHCA. It is manifest that the BHCA was not enacted to accomplish a single objective but to effectuate a comprehensive set of goals: to eliminate preferential treatment in commercial lending; to prevent the concentration of control over banking facilities, in particular, by generally barring the establishment of interstate networks of banks; to protect customers of banks from the tying of credit to other services offered by the bank or an affiliate; and to prevent threats to the solvency of banks from unsafe practices by holding company affiliates.[13] In order to effectuate these goals, the term "commercial loans" must be interpreted as broadly as is consistent with the meaning of the language.

[11] See C.A. Pet. Joint Reply Br. App. 1793.

[12] Respondents have no answer for the Board's finding (Pet. 18) that a substantial portion of the money market transactions included in the Board's definition of "commercial loans" in fact are conducted by means of direct negotiations between the borrower and lender without the use of intermediaries, and thus would qualify as commercial loans even under the narrow test asserted by respondents.

[13] 12 U.S.C. 1843(a), 1842(a), (c) and (d), 1971-1978, 1844(c); S. Rep. 1095, 84th Cong., 1st Sess. 2, 4-5, 14, 16 (1955); S. Rep. 91-1084, 91st Cong., 2d Sess. 2-4, 47-48 (1970); H.R. Rep. 91-1747, 91st Cong., 2d Sess. 11 (1970) (Statement of the Managers on the Part of the House).

Nor can respondents' asserted test of commercial lending be supported by reference to the activities of the Boston Safe Deposit & Trust Company, the company Congress was informed would be the beneficiary of the commercial lending exception. Respondents have not identified a scrap of evidence even suggesting that Congress was aware of all of the activities of Boston Safe. Indeed, since it is now clear that at the time of the commercial loan amendment Boston Safe purchased commercial paper, a transaction uniformly understood then (as now) as the making of a commercial loan, Congress could not have been aware of all of that company's activities, otherwise Congress would not have chosen commercial lending as the test for excluding that institution from the Act. The commercial lending amendment was not a private bill to exclude Boston Safe but instead an exception for institutions not engaged in making commercial loans, a term left undefined that must be interpreted in light of the overall purposes of BHCA.

Given the complete lack of support in the statute, its history and purposes for the view that direct negotiations between a lender and borrower are the determinative factor of a "commercial loan" as used in the BHCA, the Board acted reasonably in rejecting earlier interpretations that embodied that distinction. Contrary to respondents' contentions, the reexamination of the meaning of "commercial loans" as used in the Act's definition of "bank" resulted from the recent widespread use of the nonbank bank device to escape the Act's coverage, which forced the Board to look anew at the proper scope of the exemption for

non-commercial lenders to assure that the purposes of the Act are fully effectuated.[14]

3. Respondents' reliance (Br. in Opp. 12-13) on the views of the other federal banking agencies with respect to the Board's definitions is misplaced. The other agencies are not charged with administration of the BHCA and, accordingly, their views on the scope of that legislation are not entitled to any significant weight. This Court has repeatedly made clear that Congress gave the Board exclusive jurisdiction to interpret provisions of the BHCA and that the Board's jurisdiction is paramount. *Board of Governors* v. *First Lincolnwood Corp.*, 439 U.S. 234, 250-251 (1978); *Whitney National Bank* v. *Bank of New Orleans & Trust Co.*, 379 U.S. 411, 419-420 (1965). Moreover, the weight to be accorded the views of the Treasury Department, which assume that nonbank banks are permissible under current law (Br. in Opp. Addendum H), is undermined by a recent district court decision casting serious doubt on the Comptroller's authority to charter such institutions.[15] Finally, respondents completely ignore

[14] Respondents' assertion that the Board failed to provide an opportunity for public comment on the rationale for its definitions of "demand deposits" and "commercial loans" is without foundation. Prior to adopting the definitions, the Board published for comment in the *Federal Register* the text of the proposed definitions accompanied by a commentary that expressly incorporated the findings and reasoning in the Board's rulings in its *First Bancorporation* and *Dreyfus Corp.* decisions, which the proposed regulatory provisions were meant to codify. 48 Fed. Reg. 23520 (1983).

[15] *Independent Bankers Ass'n of America* v. *Conover*, No. 84-1403-CIV-J-12 (M.D. Fla. Feb. 15, 1985), slip op. 39 (order granting preliminary injunction) ("The Comptroller does

the views of state bank regulators, many of whom vigorously support the Board's adoption of the definitions of "demand deposits" and "commercial loans" (see Pet. 23).

For these reasons and the reasons stated in the petition, the petition for a writ of certiorari should be granted.

Respectfully submitted.

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I authorize the filing of this brief.

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MARCH 1985

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not serve the public interest by issuing charters to nonbank banks when their only conceivable purpose is to enable their parent companies to escape regulation under the BHCA.").

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DIMENSION FINANCIAL CORP., ET AL.

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE TENTH CIRCUIT

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(Appearances continued on inside front cover)

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*ON WRIT OF CERTIORARI TO THE
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FEDERAL RESERVE SYSTEM
12 CFR Part 225
[Docket No. R-0470]
Bank Holding Companies and Change in Bank Control; Revision of Regulation Y

BEFORE THE BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM

DATE	DESCRIPTION
May 19, 1983	Notice of proposed rulemaking issued by Board of Governors
May 25, 1983	Notice of proposed rulemaking published in Federal Register
July 18, 1983	Comment period expires
Dec. 29, 1983	Final rule approved by order of the Board of Governors
Jan. 5, 1984	Notice of final rulemaking published in Federal Register
Feb. 6, 1984	Effective date of substantive provisions of final rule

General Docket 83-2696

UNITED STATES COURT OF APPEALS
FOR THE TENTH CIRCUIT

Petition for Review of an Order of the
Board of Governors of the Federal Reserve System

Case No. 83-2696

Consolidated with 84-1011, 84-1122, 84-1257 & 84-1270
For the Purpose of Record, Briefing, Argument &
Submission. Also 84-1407

Filed 12/30/83

DIMENSION FINANCIAL CORPORATION, DANIEL T. CARROLL, HAROLD D. DUFEK, WILLIAM L. MITCHELL, RONALD L. SHAFFER, AND A. GARY SHILLING, PETITIONERS

vs.

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Board of Governors of the Federal Reserve System

12/30/83	CS. DKT.P.RVW. Case docketed; Petition for review of an agency order orig & 3 cc.
1/14/84	NAPR. F. Notice of appearance filed by Gingold, Duncan, Davidson, Perdue and Summers as attys. for Petitioners *
*1/16/84	NAPR.F Notice of appearance filed by R.M. Ashton as atty. for respondent
2/9/84	*ROA.F.* Record on appeal filed, (Certified Index) orig
2/16/84	M.F.ANY. F. Petitioners' motion for order initiating transfer of proceedings filed (orig & 6cc,c/s)
2/27/84	M.F. ANY. RES. F. Respondent's response to petitioners' motion for order initiating transfer of proceedings filed, orig. & 3cc,c/s.
2/24/84	M.CON.F—petitioners' in 84-1011 & 84-1122 motion to consolidate 83-2696, 84-1011, 84-1122 filed—orig. & 3 cc.—c/s
2/24/84	M.EXP.SCH.O.F-petitioners' in 84-1011 & 84-1122/motion to set expedited scheduling order in the three cases—orig. & 3 cc.—c/s (combined with above motion
3/1/84	*ROA.F.* Record on appeal filed, Vols. I-V (pleadings) (1870 pp.) Original (1870 tpp.)
2/27/84	M.EXTM.BR.F. Petitioners' motion for extension of time to file briefs filed, orig. & 6cc,c/s.
	M. CON. RES. F. Petitioners' response to motion of petitioners' in 84-1011 and 84-1122 to consolidate 83-2696, 84-1011, 84-1122 filed, orig. & 3cc, c/s (response incl. w/motion for extension of time to file brief)
	M.EXP. SCH. O. RES. F. Petitioners' response to petitioners' (in 84-1011 and 84-1122) motion for expedited scheduling order filed, orig. & 3 cc, c/s (incl. w/motion for extension of time to file brief and response to motion to consolidate filed above)
3/5/84	MEMO. IN SPT. F. Memorandum in support of motion to consolidate petitions for review (83-2696, 84-1011, 84-1122) and to set accelerated briefing and argument schedule filed by petitioners in 84-1011, 84-1122, orig. & 3cc,c/s.

3/1/84 M. CON. RES. F. Respondent's response to motion of petitioners in 83-269 84-1011 and 84-1122 to consolidate petitions for review filed, Orig. & 3cc., c/s.

M.EXP.SCH.RES.F. Respondent's response to petitioner's motion for expedited scheduling filed, Orig. & 3cc., c/s.

3/19/84 M. CON. DISP Granted Petitioner's motion to consolidate cases 84-1011, 84-1122, 83-2696, 84-1257 and 84-1270 disposed of by McKay and Seymour. Parties served by mail.

M. EXP. SCH. O. DISP Granted petitioner's motion to set an accelerated briefing schedule disposed of by McKay & Seymour. Parties served by mail.

O. RMK The petitioners in No. 83-2696 are designated as leading the briefing of this matter for all petitioners disposed of by McKay & Seymour. Parties served by mail.

O.ASGN.CAL Order assigned to Calendar B—Seth. Parties served by mail.

O.BR.DUE Petitioners' lead brief is due 4/9/84. Other petitioners may file statements of joinder and adoption of the lead brief or distinction of their positions in no more than 10 pages each within 10 days thereafter. A joint brief is strongly encouraged. Duplicative arguments will not be favored. Respondent may file a brief of no more than 75 pages within 21 days of service of petitioner's brief. Lead petitioners may file a reply brief within 10 days of service of respondent's brief. Other petitioners may file separate reply briefs of no more than 5 pages each if necessary within 7 days of service of the lead brief disposed of by McKay & Seymour. Parties served by mail.

NAPR.F. Notice of appearance filed by Harris as attorney for petitione State of Ohio and Huddleston (84-1270

3/15/84 *ROA.F.* Record on appeal filed, (Supplemental Certified List), Orig. only.

3/26/84 NAPR.F. Notice of appearance filed by Ashton, attorney for appellee

3/29/84 M.CON.F. Petitioner's motion to consolidate filed, orig & 3cc, c/s moot-see order of March 28, 1984.

4/3/84 HRG.SET MAY., '84 TERM, DENVER

4/5/34 NAPR.F. Notice of appearance filed by Blount, Jernigan & Arnold as attys. for appellant. (84-1407)

*4/9/84 BR.F Appellant's brief filed, orig and 10cc, c/s.

NAPR.F Notice of appearance filed by Ashton as attorney for respondent in No. 84-1407.

*4/6/84 NAPR.F. Notice of appearance filed by Ashton as attorney for responden

4/18/84 M.F.BR. Motion to file brief filed.

M.F.BR.DISP. Petitioner's motion to file brief filed, (orig. & 13 cc,c/s, granted to file, RLH, parties notified by mail.

BR.F. Petitioner's brief filed, orig. & 13cc. c/s.

ADD.AUTH.F. Petitioner's additional authority filed, orig. & 25 cc. c/s

4/19/84 ADD. AUTH. F. Petitioner's additional authority filed, orig. & 9 cc.c/s. for 84-1011

ADD. AUTH. F. Intervenors American Financial Services and Household Finance additional authority filed, orig. & 9cc., c/s for 84-1122.

ADD.AUTH.F. Petitioner's additional authority filed, orig. & 9cc, c/s for 84-1122.

4/20/84 *ROA.F.* Record on appeal filed, (Supplemental Certified List) orig.

4/30/84 M.BC. PARTY.F Motion to become a party as amicus curiae filed by Conference of State Bank Supervisors, filed, orig + 9 cc,c/s

*4/30/84 BR.F. (Conference of State Bank Supervisors) Amicus Brief (received but not filed) orig + 9 cc, c/s

5/1/84 BR.F. Respondent's brief filed, orig & 9cc,cs

APX.F. Respondent's appendix filed, orig & 9cc, c/s

5/7/84 BR.F. Petitioner's reply brief filed, orig & 10cc, c/s

5/10/84 BR.F Petitioners' (Dimension, Carroll, Dufek, Mitchell, Shaffer, Shilling, State of Ohil, Ohio Div.

of Svgs. and Loan, Financial Institutions Assurance Corp) reply brief filed, orig. + 9 cc., c/s

5/11/84 BR.F. Petitioners' supplemental reply brief filed, orig and 25cc, c/s (filed in 84-1407)

5/14/85 CS.ARG.SUBM—case argued and submitted—Seth, Doyle, Seymour

9/24/84 OPN.F. Published, signed opinion filed. Seth, Doyle, Seymour Writing Judge is Seth

JM.DISP. Judgment set aside. The Bd shall not attempt to enforce or implemnt such changes herein held invalid.

10/15/84 M.F.ANY.F. Respondent's motion for clarification of opinion filed Orig.

M.STAY.ISS. MDT.F. Respondent's motion to stay mandate until 11/14/84 pending application for cert. 0&3 c/s.

M.STAY.ISS.MDT.RES.F. Petitioners (Dimension Finance) objection to respondent's motion for stay of mandate unti 11/14/84 filed. 0&3 c/s

10/22/84 M.STAY.ISS.MDT.RES.F Petitioner's (Financial Institutions Assur objection to respondent's motion for stay of mandate filed 0&2 c/s

10/25/84 M.STAY.ISS.MDT.RES.F Petitioners' (State of Ohio and Ohio Div. of Savings and Loan Assns.) response in opposition to respondent's motion for stay of mandate filed orig. + 3cc., c/s

10/30/84 OPN.RMK. Opinion correction. Substitute new pages 3 and 4.

11/5/84 M.STAY.ISS.MDT.RES.RPL.F Respondent's reply to petitioner's response to respondent's motion to stay issuance of mandate filed, orig. + 3 cc., c/s

12/18/84 RMK.F. Notification that S.C. has granted extension of time to 1/22/85 to file for cert.

2/14/85 M.STAY.ISS.MDT.DISP. Denied respondent's motion for stay of issuance of mandate. Seth, Doyle, Seymour—parties notified by mail MDT.ISS. Mandate issued to Bd of Governors of Federal Reserve System

2/19/85 P.WRIT.CERT.F. Respondent's (Bd of Governors) petition for writ of cert filed on 2/6/85. S.C. No. 84-1274

2/20/85 OPN.RMK. Opinion correction—substitute new page 22.

2/26/85 MDT. RCPT. F Mandate receipt filed.

5/7/85 P. WRIT.CERT.DISP. Granted respondent's petition for writ of cert. on 4/29/85.

General Docket 84-1011

UNITED STATES COURT OF APPEALS
FOR THE TENTH CIRCUIT

Petition for Review of an Order of the
Board of Governors of the Federal Reserve System

Case No. 84-1011

Consolidated with 83-2696, 84-1122, 84-1257 & 84-1270
For the Procedural Purposes of Record, Briefing,
Argument & Submission.

FIRST BANCORPORATION, PETITIONER,

vs.

BOARD OF GOVERNORS OF THE FEDERAL RESERVE
SYSTEM, RESPONDENT.

ATTORNEYS FOR APPELLANT:

(A) KENT B. LINEBAUGH
( ) WILLIAM G. MARSDEN
JARDINE, LINEBAUGH, BROWN & DUNN
(A) JOHN D. HAWKE, JR.
(A) LEONARD H. BECKER
( ) JOHN A. KRONSTADT
(A) DOUGLAS L. WALD
ARNOLD & PORTER

1/5/84 CS.DKT. Case docketed; petition for review of a Board order, orig. + 9 cc, c/s.
M.F.ANY.F Petitioner's letter motion suggesting that 84-1011 be submitted to the same panel as case No. 82-1401. Board's order attached. Filed orig. + 9 cc, c/s.

1/24/84 NAPR.F. Notice of appearance filed by Hawke, Becker and Wald as attys for Petitioner

1/31/84 NAPR.F. Notice of appearance filed by Linebaugh as atty. for First Bancorporation, petitioner.

2/20/84 *ROA.F* Record on appeal filed (certified list) orit

2/24/84 M.CON.F.—petitioners' motion to consolidate 83-2696, 84-1011, 84-1122 filed—orig. & 3 cc.—c/s
M.EXP.SCH.O.F.—petitioners' motion to set expedited scheduling order filed—orig. & 3 cc.—c/s (combined with above motion)

* * *ROA.F.* Record on appeal filed, Vols. I-V (pleadings) (1870 pp.) Original (1870 tpp.)

3/5/84 MEMO.IN.SPT.F. Petitioners' memorandum in support of motion to consolidate 84-1011, 84-1122, 83-2696 and to set accelerated briefing and argument schedule/filed, orig. & 3cc, c/s.

**3/1/84 M.CON.RES.F Respondent's response to motion of petitioners in 83-2696, 84-1011 & 84-1122 to consolidate petitions for review filed, Orig. & 3cc., c/s.
M.EXP.SCH.RES.F Respondent's response to petitioner's motion for expedited scheduling filed, Orig. & 3cc., c/s.

3/19/84 M.CON.DISP Granted Petitioner's motion to consolidate cases 84-1011, 84-1122, 83-2696, 84-1257 and 84-1270 disposed of by McKay and Seymour. Parties served by mail.
M.EXP.SCH.O.DISP Granted petitioner's motion to set an accelerated briefing schedule disposed of by McKay & Seymour. Parties served by mail.
O.RMK The petitioners in No. 83-2696 are designated as leading the briefing of this matter for all petitioners disposed of by McKay & Seymour. Parties served by mail.
O.ASGN.CAL Order assigned to Calendar B—Seth. Parties served by mail.
O.BR.DUE Petitioners' lead brief is due 4/9/84. Other petitioners may file statements of joinder and adoption of the lead brief or distinction of their positions in no more than 10 pages each within 10 days thereafter. A joint brief is strongly encouraged. Duplicative arguments will not be favored. Respondent may file a brief of no more than 75

pages within 21 days of service of petitioner's brief. Lead petitioners may file a reply brief within 10 days of service of respondent's brief. Other petitioners may file separate reply briefs of no more than 5 pages each if necessary within 7 days of service of the lead brief disposed of by McKay & Seymour. Parties served by mail. FOR FURTHER DOCKET ENTRIES, SEE CASE NO. 83-2696

General Docket 84-1122

UNITED STATES COURT OF APPEALS
FOR THE TENTH CIRCUIT

Petition for Review of an Order
Of the Board of Governors of the Federal Reserve System

Case No. 84-1122

Consolidated with 83-2696, 84-11011, 84-1257 & 84-1270
for the Procedural Purposes of Record
Briefing, Argument and Submission
COLORADO INDUSTRIAL BANKERS, ASSOCIATION, FORT LUPTON INDUSTRIAL BANK, MONROE INDUSTRIAL BANK, CASTLE ROCK INDUSTRIAL BANK, ARK VALLEY INDUSTRIAL BANK, HOUSEHOLD WELD COUNTY INDUSTRIAL BANK, HOUSEHOLD LAMAR INDUSTRIAL BANK, HOUSEHOLD ALAMOSA INDUSTRIAL BANK, HOUSEHOLD VALLEY INDUSTRIAL BANK, HOUSEHOLD SALIDA INDUSTRIAL BANK, COPPER STATE THRIFT & LOAN COMPANY, AND COPPER STATE FINANCIAL CORPORATION, PETITIONERS,

vs.

BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM, RESPONDENT.

AMERICAN FINANCIAL SERVICES ASSOCIATION, HOUSEHOLD FINANCE CORPORATION, (2/16/84 Order) INTERVENORS

ATTORNEYS FOR APPELLANT

(A) LEONARD H. BECKER
(A) JOHN D. HAWKE, JR.
(A) DOUGLAS L. WALD
( ) EDWARD L. WOLF
ARNOLD & PORTER

(A) JAMES J. SANDMAN
ARNOLD & SANDMAN

( ) STEPHEN A. HELLERSTEIN
Hellerstein, Hellerstein & Shore, P.C.

ATTORNEYS FOR APPELLEE

(A) RICHARD M. ASHTON
Assistant General Counsel
Board of Governors of the Federal Reserve System

INTERVENORS:
( ) John D. Hawke, Jr.
( ) Leonard H. Becker
( ) Douglas L. Wald
( ) Edward L. Wolf
Arnold & Porter

1/27/84 CS.DKT.P.RVW. Case Docketed; Petition for review of an agency order.
M.BC.PARTY.F Motion to intervene filed by American Financial Services Association and Household Finance Corp., orig +3cc,c/s

2/16/84 M.BC.PARTY. DISP—granted motion to intervene filed by American Financial Services Association—McKay, Seymour
M.BC.PARTY.DISP—granted motion to intervene filed by Household Finance Corporation—McKay, Seymour

2/6/84 NAPR.F Notice of appearance filed by Ashton as attorney for Appellee.

2/3/84 NAPR.F. Notice of appearance filed by Sandman as attorney for Appellant

2/3/84 NAPR.F Notice of appearance filed by Hawkw & Becker as attorneys for Appellant.

2/24/84 M.CON.F.—petitioners' motion to consolidate 83-2696, 84-1011, 84-1122 filed —orig. & 3 cc.—c/s
M.EXP.SCH.O.F—petitioners' motion to set expedited scheduling order filed—orig. & 3 cc.—c/s (combined with above motion)

3/1/84 *ROA.F.* Record on appeal filed, Vols. I-V (pleadings) (1870 pp.) Original (1870 ιpp.)

*3/5/84 MEMO.IN.SPT.F. Petitioners' memorandum in support of motion to consolidate 84-1011, 84-1122, 83-2696 and to set accelerated briefing and argument schedule filed, orig. & 3cc,c/s.

3/1/84 M.CON.RES.F Respondent's response to motion of petitioners in 83-2696, 84-1011 & 84-1122 to consolidate petitions for review filed, Orig. & 3cc., c/s.
M.EXP.SCH.RES.F Respondent's response to petitioner's motion for expedited scheduling filed, Orig. & 3cc.,c/s

3/19/84 M.CON.DISP Granted Petitioner's motion to consolidate cases 84-1011, 84-1122, 83-2696, 84-1257 and 84-1270 disposed of by McKay and Seymour. Parties served by mail.
M.EXP. SCH.O.DISP Granted petitioner's motion to set an accelerated briefing schedule disposed of by McKay & Seymour. Parties served by mail
O.RMK The petitioners in No. 83-2696 are designated as leading the briefing of this matter for all petitioners disposed of by McKay & Seymour. Partes served by mail.
O.ASGN.CAL Order assigned to Calendar B—Seth. Parties served by mail.
O.BR.DUE Petitioners' lead brief is due 4/9/84. Other petitioners bay file statements of joinder and adoption of the lead brief or distinction of their positions in no more than 10 pages each within each 10 days thereafter. A joint brief is strongly encourag Duplicative arguments will not be favored. Respondent may file a brief of no more than 75 pages within 21 days of service of petitioner's brief. Lead petitioners may file a reply brief within 10 days of service of respondent's brief. Other petitioners may file separate reply briefs of no more than 5 pages each if necessary within 7 days of service of the lead brief disposed of by McKay & Seymour. Parties served by mail. FOR FURTHER DOCKET ENTRIES, SEE CASE NO. 83-2696.

General Docket 84-1257

UNITED STATES COURT OF APPEALS
FOR THE TENTH CIRCUIT

Petition to Review an Order of the Board of Governors of the Federal Reserve System

Case No. 84-1257

Transferred from the Sixth Circuit—their no. 84-3089 Related to #84-1270 Consolidated with 83-2696, 84-1011, 84-1122 & 84-1270 for the Procedural Purposes of Record, Briefing, Argument & Submission.

OHIO DEPOSIT GUARANTEE FUND;HORIZON SAVINGS AND LOAN COMPANY; PERMANENT SAVINGS AND LOAN ASSOCIATION; HORIZON SERVICE CORPORATION, PETITIONERS,

vs.

BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM; PAUL A. VOLCKER; PRESTON MARTIN; NANCY H. TEETERS; HENRY C. WALLICH; J. CHARLES PARTEE; EMMETT J. RICE; LYLE E. GRAMLEY, RESPONDENTS.

ATTORNEYS FOR APPELLANT:
For: Ohio Deposit Guarantee Fund:
( ) PHILIP A. BROWN
( ) ROGER A. YURCHUCK
(A) THOMAS B. RIDGLEY
( ) JOHN J. KULEWICZ
VORYS, SATER, SEYMOUR & PEASE

ATTORNEYS FOR APPELLEE:
(A) RICHARD M. ASHTON
Board of Governors of the Federal Reserve System

1984

1/30 1) Petition to Review an Order of the Board of Governors of the Federal Reserve System (m-no service)

1/30 Certified copy of petition issued to respondent pursuant to Rule 15, FRAP

2/3 2) Motion: petitioner to stay 12/29/84 decision of the Board of Governors of the Federal Reserve System pending appeal (m-2/3)

2/7 3) Order directing oral arguments on the request for stay 2/14/84, declining to issue a stay in the interim, expediting the briefing schedule on the merits for oral argument at the earliest practicable date, and requesting respondents to file a response to the petition for stay by 2/10/84 (Merritt, Kennedy and Wellford, JJ.)

2/10 4) Response: respondents' in opposition to motion for stay (m-2/10) [84-3091]

2/13 5) Reply memorandum of petitioners in support of motion for stay (m-2/13)

2/14 6) Corrected copies of respondents' opposition to motion for stay (m-2/13) [84-3091]

2/14 Cause argued for stay pending review by Ridgley and Harris for petitioners, by Ashton for respondents and case submitted to the Court (Before: Merritt, Kennedy and Wellford, JJ.)

2/16 7) Order denying motion for stay pending review, with instructions (Merritt, Kennedy and Wellford, JJ.)

2/16 8) Letter to parties requesting briefs pursuant to instructions set forth in the 2/16/84 order and extending briefing schedule one week, petitioner's brief to 2/28

2/16 9) Pre-Argument Statement filed on behalf of petitioner.

2/16 10) Appearance of T. Ridgley for the Petitioners.

2/20 11) Memorandum of appellant pursuant to Court's 2/16/84 order (m-2/20)

2/20 12) Memorandum of appellee pursuant to Court's 2/16/84 order (m-2/17)

2/20 13) Appearance of R. Ashton for the Respondent, Board of Governors of the Federal Reserve System.

2/21 13) Order transferring appeals 84-3089 and 84-3091 to U.S.C.A., 10th Cir., and vacating the Court's

expedited briefing schedule of 2/10/84 (Merritt, Kennedy and Wellford, JJ.)

2/21 Certified copy of item 12, contents of office file and copies of the approporiate docket sheets sent to U.S.C.A., 10th Cir.

2/21 Certified copy of item 12 sent to Board of Governors of the Federal Reserve System

2/28/84 CS.DKT.P.RVW. Case docketed. Petition for review. (Transfer from the Sixth Circuit No. 84-3089)

3/1/84 *ROA.F.* Record on appeal filed, Vols. I-V (pleadings) (1870 pp.) Original (1870 tpp.)

3/9/84 NAPR.F. Notice of appearance filed by Ridgley, Yurchuck, Brown & Kulewicz, attys for appellant Ohio Deposit Guarantee Fund.

3/19/84 O.CS.CON. Order cases 84-1011, 84-1122, 83-2696, 84-1257 and 84-1270 consolidated disposed of by McKay & Seymour. Parties served by mai O.RMK For full order and briefing schedule, refer to case 83-2696. FOR FURTHER DOCKET ENTRIES, SEE 83-2696.

General Docket 84-1270

UNITED STATES COURT OF APPEALS
FOR THE TENTH CIRCUIT

Petition to Review an Order of the
Board of Governors Federal Reserve System

Case No. 84-1270

Consolidated with 83-2696, 84-1011, 84-1122 & 84-1257 for the Purpose of Record,
Briefing Argument & Submission. Transferred from the Sixth Circuit—their no. 84-3091 related to #84-1257

STATE OF OHIO; C. LAWRENCE HUDDLESTON, DIRECTOR; OHIO DIVISION OF SAVINGS AND LOAN ASSOCIATIONS, PETITIONERS,

vs.

BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM; PAUL A. VOLCKER; PRESTON MARTIN; NANCY H. TEETERS; HENRY C. WALLICH; J. CHARLES PARTEE; EMETT J. RICE; LYLE E. GRAMLEY, RESPONDENTS.

ATTORNEYS FOR APPELLANT:

(A) THOMAS B. RIDGLEY
Vorys, Sater, Seymour & Pease

(X) ANTHONY J. CELEBREZZE, JR.
Attorney General

(A) CONNIE J. HARRIS
Assistant Attorney General

ATTORNEYS FOR APPELLEE:

(a) RICHARD M. ASHTON

1984

1/30 1) Petition to Review an Order of the Board of Governors of the Federal Reserve System (m-no service)

1/30 Certified copy of petition issued to respondent pursuant to Rule 15, FRAP

2/3 2) Motion: petitioner for stay Board of Governors of the Federal Reserve System's order of Dec. 29, 1984 pending appeal (m-2/3)

2/7 3) Order directing oral argument on the request for stay 2/14/84, declining to issue a stay in the interim, expediting the briefing schedule on the merits for oral argument at the earliest practicable date, and requesting respondents to file a response to the petition for stay by 2/10/84 (Merritt, Kennedy and Wellford, JJ.)

2/10 4) Response: respondents' in opposition to motion for stay (m-2/10) [84-3089]

2/13 5) Supplemental memorandum (7) of petitioners' in support of motion for stay (m-2/13)

2/14 6) Corrected copies of respondents' opposition to motion for stay (m-2/13) [84-3089]

2/14 Cause argued for stay pending review by Ridgley and Harris for petitioners, by Ashton for respondents and case submitted to the Court (Before: Merritt, Kennedy and Wellford, JJ.)

2/16 7) Order denying motion for stay pending review, with instructions (Merritt, Kennedy and Wellford, JJ.)

2/16 8) Letter to parties requesting briefs pursuant to instructions set forth in the 2/16/84 order and extending briefing schedule 1 week, petitioners' brief due 2/28

2/20 9) Memorandum of appellee's pursuant to Court's 2/16 order (m-2/17)

2/21 10) Letter sent requesting pre-argument statement by 3/2

2/21 11) Memorandum of petitioners on the issue of transfer (m-2/20)

2/21 12) Order transferring appeals 84-3089 and 84-3091 to U.S. Ct. of Appeals for the 10th Cir. and vacating the Court's expedited briefing schedule of 2/10/84 (Merritt, Kennedy and Wellford, JJ.)

2/21 Certified copy of item 12, contents of the office file and copies of the appropriate docket sheets sent to U.S.C.A., 10th Cir.

2/21 Certified copy of item 12 sent to Board of Governors of the Federal Reserve System

2/28/84 CS.DKT.P.RVW. Case docketed. Petition for review. (Transfer from the Sixth Circuit No. 84-3091)

3/1/84 *ROA.F.* Record on appeal filed, Vols. I-V (pleadings) (1870 pp.) Original (1870 tpp.)

3/19 O.CS.CON Order cases 84-1011, 84-1122, 83-2696, 84-1257 and 84-1270 consolidated disposed of by McKay & Seymour. Parties served by mail O.RMK For full order and briefing schedule, refer to case 83-2696. FOR FURTHER DOCKET ENTRIES, SEE 83-2696.

General Docket 84-1407

UNITED STATES COURT OF APPEALS
FOR THE TENTH CIRCUIT

Petition to Review an Order of the
Board of Governors of the Federal Reserve System

Case No. 84-1407

Transferred from the Fourth Circuit—their no. 84-1101
Consolidated with 83-2696, 84-1011, 84-1122, 84-1257, & 84-1270 for the Procedural Purposes of Record, Briefing, Argument & Submission

FINANCIAL INSTITUTIONS ASSURANCE CORPORATION,
PETITIONER,

vs.

BOARD OF GOVERNORS OF THE
FEDERAL RESERVE SYSTEM, RESPONDENT.

ATTORNEYS FOR APPELLANT:

(A) JOHN H. ANDERSON
(A) JOHN L. JERNIGAN
(A) R. MARKS ARNOLD
Smith, Anderson, Blount,
Dorset, Mitchell & Jernig

(A) JAMES D. BLOUNT

01-27-84 Case docketed. Awaiting ROA. mh
02-16 DISCLOSURE STMNT. P,N,filed. mh
02-23-84 MOTION (B-142) of P to transfer case to U.S. Court of Appeals for the Tenth Circuit, filed. ses
03-05-84 RESPONSE (B-142) of R to motion to transfer case, filed. ses
03-07-84 Motion (B-142) and response to transfer proceedings transmitted to JDP,*JMS,JDB. (ses)

03-19-84 ORDER granting Rs motion to transfer case to U.S. Court of Appeals for the Tenth Circuit, filed. Copies to Jernigan, Ashton, Mattingly & Tenth Circuit. ses.
3-27 SS.DKT.R.RVW. Case docketed. Petition for review. (Transfer from the Fourth Circuit No. 84-1101)
*PLEADINGS FILED IN EARLIER CASE #83-2696, 84-1011, 84-1122, 84-1257 & 84-1270.
*ROA.F. Record on appeal filed, Vols. I-V (pleadings (1870 pp.) Original (1870 tpp.)
3/28/84 CT.M On the court's own motion, the captioned appeal is ordered consolidated with the appeals in Nos. 83-2696, 84-1011, 84-1122, 84-1257 and 84-1270. Petitioner Financial Institutions Assurance Corporation whall comply with the briefing schedule established in the consolidated cases by order of March 19, 1984, as it pertains to petitioners other than the lead petitioners, disposed of by McKay and Seymour. Parties served by mail.
FOR FURTHER DOCKET ENTRIES, SEE DOCKET NO. 83-2696

BRADFORD NATIONAL CORPORATION
67 BROAD STREET-NEW YORK, N.Y. 10004

Legal Division
Writer's Direct Line

212-530-7880 June 23, 1983

Secretary
Board of Governors of
The Federal Reserve System
Washington, D.C. 20551

Re: Proposed Revision of Regulation Y,
Federal Register Notice—Docket No. R-0470

Gentlemen:

I am writing as counsel to Bradford National Corporation ("BNC") and its related companies, to comment upon certain aspects of the proposed revision of Regulation Y, promulgated under the Bank Holding Company Act of 1956, as amended (the "BHC Act"), which was recently published for comment by the Board of Governors of the Federal Reserve System (the "Board") (hereinafter "the Proposed Regulation").[1] We are specifically concerned with the effect upon BNC of the definition of the term "Commercial loans" added to Regulation Y for the first time by the Proposed Regulation.[2] We strongly believe that if the Board determines to expand the definition of "Commercial loans" for purposes of Section 2(c) of the BHC Act in the manner proposed, that it should also fully grandfather the lending and deposit taking powers of institutions such as BNC's trust company subsidiaries that have relied in good faith upon the Board's and its staff's prior contrary interpretations under the BHC Act and Regulation Y.

Section 2(c) of the BHC Act defines the term "bank" as any institution that both accepts demand deposits and engages in the business of making commercial loans BNC has

[1] Notice of Proposed Rulemaking, 48 Fed. Reg. 23520 (May 25, 1983); comments are due by July 18, 1983.

[2] Proposed Regulation § 225.2(a)(1)(ii). Prior to the Proposed Regulation, Section 225.1(b) of Regulation Y simply adopted the definitions of the BHC Act.

for many years relied upon the fact that its trust company subsidiaries do not engage in the business of making commercial loans as justification for its exemption from the BHC Act, and from any restriction upon their deposit taking powers.

Section 225.2(a)(1)(ii) of the Proposed Regulation defines the term "commercial loans", without qualification, to include "the purchase of commercial paper, certificates of deposit, bankers' acceptances, and similar money market instruments, the extension of broker call loans, the sale of federal funds, and the deposit of interest-bearing funds." The inclusion of these types of money market investments as "commercial loans" is directly contrary to Board and staff rulings pertaining to such companies as Boston Safe Deposit and Trust Company ("Boston Safe") and BNC. It is also inconsistent with the exemption of such "loans" made by nonbank trust companies authorized under Section 4 of the BHC Act by Section 225.4(a)(4) of Regulation Y, and under Section 225.23(b)(3) of the Proposed Regulation.

This construction of the term "commercial loans" was promulgated by the Board in its letter of December 10, 1982 to Mr. William M. Isaac, Chairman, Federal Deposit Insurance Corporation, pertaining to the proposed acquisition by the Dreyfus Corporation of Lincoln State Bank, East Orange, New Jersey (hereinafter the "Dreyfus Interpretation"). In the Dreyfus Interpretation, the Board reaffirmed the broad definition of "commercial loans" for purposes of Section 2(c) of the BHC Act contained in its 1972 decision regarding Boston Safe Deposit and Trust Company ("Boston Safe").[3] As so defined, "commercial loans" included "all loans to an individual, secured or unsecured, other than a loan the proceeds of which are used to acquire property or services used by the borrower for his own personal, family or household purposes, or for charitable purposes." However, as to Boston Safe, the Board further concluded that "commercial loans"

[3] *See*, Letter from Michael A. Greenspan, Assistant Secretary to the Board of Governors of the Federal Reserve System, to Lee J. Aubrey, Federal Reserve Bank of Boston (May 18, 1972). *See also*, Letter from Kenneth A. Kenyon, Deputy Secretary of the Board of Governors of the Federal Reserve System, to Biagio M. Maggiacomo, Greater Providence Deposit Corporation (July 1, 1971).

did *not* include "the purchase of 'money market instruments', such as certificates of deposit, commercial paper, and bank acceptances." The Board also concluded that "the sale of Federal funds by Boston Safe is not tantamount to the making of a commercial loan, for purposes of the Act."

We believe that the justification of the Board's exemption of Boston Safe from the BHC Act, as embodied in subsequent rules and interpretations regarding trust companies by both the Board and its staff, including the exemption previously granted to BNC (through its predecessor—Bradford Computer Systems, Inc.),[4] all as discussed below, continue to fully apply to BNC and its related trust companies. Moreover, we believe that the Dreyful Interpretation reflected the Board's concern with the growing number of "nonbank banks" and was not intended to affect companies such as BNC which had operated under this exemption for some time.[5] We had been reassured by the Board's staff, as well as by staff at the Federal Reserve Bank of New York, that the Board had not decided to apply the Dreyfus Interpretation retroactively. Moreover, Board staff had advised us that the Dreyfus Interpretation was not directed at trust companies operating under this exemption. Accordingly, it appears to us that the Proposed Regulation, absent an express grandfather for BNC and similarly situated companies, goes far beyond the Dreyfus Interpretation and will adversely and unnecessarily affect companies that the Board and its staff had previously held exempt from the BHC Act.

BNC and its related companies have performed the function of offering services in competition with, in many cases, large commercial banking organizations, and have made, we believe, a highly positive contribution to these markets. This was recognized by the Board in its order approving a joint venture between Crocker National Corporation and Western

[4] *See*, Letter from Baldwin B. Tuttle, Deputy General Counsel of the Board of Governors of the Federal Reserve System to Michael A. Greenspan, Esq., counsel to Bradford Computer Systems Inc. (1/26/76), (hereinafter sometimes called the "Tuttle letter").

[5] The Dreyfus Interpretation acknowledges, at page 2: "Between 1970 and 1981, the exemption remained within the narrow confines intended by Congress".

Bradford Trust Company, which concluded that the joint venture would constitute a viable competitive alternative to the large New York banks which dominated corporate trust services provided by bank related organizations.[6] Moreover, as a wholesaler of financial services, including asset management systems and related services, BNC and its related companies offer a means for smaller banking organizations to compete with the large money center bank holding companies as well as unregulated providers of financial services. Continued exemption of BNC from the BHC Act would enable it to continue to perform this valuable function in the marketplace.

BNC and its affiliated trust companies have long provided a range of services to broker/dealers and banks. Bradford Trust Company, New York, New York ("BTC") is a state chartered, Federal Reserve member trust company, that acts as a trustee/custodian for over $40 billion in assets (largely securities). In this capacity, BTC performs functions that parallel the functions of companies such as Boston Safe. However, BTC's functions in this capacity are substantially narrower than those of a traditional trust company. BTC's custody assets are almost entirely managed by banks and other advisors. Except in very limited circumstances, BTC does not have or exercise investment discretion with respect to such assets. Rather, it acts as a physical custodian and recordkeeper. BTC also acts as a named transfer agent or servicer for the named transfer agent for a number of issuers and bank transfer agents, although BTC subcontracts these duties to one or more of its affiliates.

In addition, BTC, through its Clearing Division (formerly Bradford Securities Processing Services, Inc.) is one of the largest independent municipal bond clearing entities. It clears U.S. Government and municipal securities, and offers securities (including equity securities) drafting services. Incident to these clearing activities, BTC extends credit to its broker/dealer customers that clear or draft securities through BTC, which credit is fully collateralized by such securities.

[6] 40 *Fed. Reg.* 1569 (January 8, 1975).

BTC's lending activities have been extensively reviewed by officials and staff at all levels of the Federal Reserve System (BTC has been a member bank since 1977), and were specifically addressed by the Board's Legal Division in the Tuttle letter. In that letter, the Legal Division concluded that, in general, if a trust company such as BTC confined its activities to those specified under the provisions pertaining to nonbank trust companies of the Board's Regulation Y, it would not come within the definition of "bank" in Section 2(c) of the BHC Act. The letter also reaffirmed that BTC's broker call loans would not be deemed to be commercial loans so long as they constituted merely a method of investing a trust company's idle funds and did not constitute a type of revolving business loan, and specifically found that BTC's "sold security transactions" would not cause BTC to be deemed to be engaged in the business of making commercial loans within the meaning of section 2(c).

BTC's (and BTCB's and STC's) clearance related financings fall within the parameters previously set by the Board and its staff, and are also consistent with the regulatory structure established by the Board to govern activities of nonbank trust companies under Section 4 of the BHC Act. Any retrenchment of these activities as to BTC, BTCB and STC would substantially damage their competitive viability. We believe that BTC's role in the securities clearance market, whose participants include major banking organizations, operating through both bank and nonbank subsidiaries, has been highly beneficial. As evidenced by the hiring of BTC's key personnel, our competitors have acknowledged this to be the case.[7] Moreover, inasmuch as the market for these services includes nonbank clearing agencies as well as banks and nonbank trust companies, there seems little danger that the Bradford organization's clearing related financing would serve as a vehicle to evade interstate restrictions on banking.

[7] While BNC has strongly opposed the hiring of its key personnel by Security Pacific Clearing and Services Inc., a nonbanking corporation owned by Security Pacific Corporation, as both unfair competition and as being anticompetitive, it is a mark of BTC's experience and innovative approach to the securities clearance market that it should be so favored by its competitors.

BTC also accepts demand and time deposits incident to its trust activities, as well as demand accounts incident to its clearing functions. Deposits taken in the latter capacity are essentially the same as credit balances accepted by nonbank clearing entities, that have not been treated as "deposits" for purposes of the BHC Act. Indeed, one of our competitors, Security Pacific Clearing and Services, Inc. ("SPCSCI")—a wholly owned nonbank subsidiary of Security Pacific Corporation—has acknowledged holding some $150 million of such customer credit balances. Since SPCSCI takes the position that it may pay interest on these nonreservable credit balances (notwithstanding the prohibition upon payment of interest on deposits contained in Section 225.4(a)(4) of Regulation Y and Section 225.23(b)(3) of the Proposed Regulation), it is becoming a competitive necessity for BTC to be able to offer MMDA deposits (and, when available, Super NOW accounts) to its clearing customers.

Bradford Trust Company of Boston ("BTCB") is a state chartered FDIC insured trust company that provides recordkeeping services for several large mutual fund companies. BTCB has participated in securities clearance loans originated by BTC and has taken demand and time deposits incident to its trust services. In addition, BTCB has accepted All Saver and MMDA deposits that were brokered to it by financial intermediaries.

A third trust company, Security Trust Company of California ("STC") is a state chartered FDIC insured trust company which, by the terms of its charter, is limited to engaging in securities clearance operations similar to those of BTC and providing trust services to IRA, Keogh and other pension plans. Its securities lending and deposit taking activities are essentially the same as those of BTC.

All of BNC's trust company subsidiaries sell, on occasion, Federal funds as an incident to their clearing activities and to utilize idle funds. For example, in the normal course, BTC will not know the full amount of clearing loans that will be required of it by its broker/dealer customers inasmuch as the volume of such loans is directly dependent upon the completion of securities trades cleared during the day. To assure that it has adequate funding for this activity, BTC will pur-

chase Federal funds in the amount that appears necessary and will sell the residue of such funds that remain unused at the end of the day. For lending limit purposes, BTC will participate out any excess amount of its clearance loans. A determination that the sale of Federal funds in this context constitutes the making of commercial loans would therefore have an extremely adverse effect upon BTC's clearing operation. It would be particularly inappropriate since BNC's trust company subsidiaries are "depository institutions" as defined by the Monetary Control Act of 1980, and maintain required reserves under the Board's Regulation D. Thus, no monetary policy purpose would be served by barring these companies from the market for Federal funds. In the ten years or so that BTC has been in existence, moreover, no examiner, or other representative of the Federal Reserve System has ever suggested that BNC would be deemed to be subject to registration under the BHC Act owing to the sale of Federal funds by BTC.

For the reasons stated, we believe it would be appropriate for the Board to fully grandfather BNC and its trust company subsidiaries and other similarly situated trust companies. Such a grandfather should be drafted so as to permit them to continue in the types of "lending" activities in which they have long engaged, with the knowledge of and without objection from the Board. It should also permit them to continue to be free from restrictions on their deposit taking authority.

The Board has recognized that grandfathering may be an appropriate remedy. For example, when Regulation Y was amended to substantially narrow the scope of the Section 4(c)(5) exemption from the nonbank prohibitions of the BHC Act, Section 225.4(e) of Regulation Y was drafted to apply only to acquisitions made after a grandfather date. Given BNC's reliance on longstanding Board and staff interpretations, it appears that this instance is one in which such grandfathering is appropriate.

We would be pleased to offer any assistance you might wish in drafting an appropriate grandfather provision.

Very truly yours,

/S/ Lawrence D. Fruchtman

LAWRENCE D. FRUCHTMAN
Associate Counsel

LDF/lm

cc: Michael Bradfield, General Counsel
Federal Reserve Board

Virgil Mattingly, Associate General Counsel
Federal Reserve Board

Ernest T. Patrikis, Senior Vice President
and Deputy General Counsel
Federal Reserve Bank of New York

FEDERAL RESERVE BANK OF SAN FRANCISCO
San Francisco, California 94120

July 8, 1983

Mr. William W. Wiles
Secretary
Board of Governors of the
Federal Reserve System
Washington, D.C. 20551

Re: Docket R-0470

Dear Mr. Wiles:

* * * * *

225.2(a)(1). This definition is clearly intended to incorporate into the regulation the position that the Board has already taken in the *Beehive* and *Dreyfus* rulings. However, we are not convinced that the Board's expansive reading of "bank" is justified, or that that Congress intended that so-called "nonbank banks" be subject to Board authority under the Bank Holding Company Act.

Furthermore, we note that section 3(e) of the BHC Act requires that every banking subsidiary of the holding company be insured by the FDIC. If the Board and the FDIC definitions of "bank" differ, an institution that comes within the Board's definition but not within the FDIC's definition could not be acquired by a bank holding company. Surely this is not what Congress intended.

* * * * *

COMPTROLLER OF THE CURRENCY
ADMINISTRATOR OF NATIONAL BANKS
Washington, D.C. 20219

July 15, 1983

Mr. William W. Wiles
Secretary, Board of Governors of
The Federal Reserve System
Washington, D.C. 20551

Re: Docket No. R-0470

Dear Mr. Wiles:

* * * * *

EXPANSION OF FRB JURISDICTION

As proposed, revised Regulation Y would redefine commonly accepted banking terms to expand the Board's jurisdiction over transactions subject to its approval. This expansion would primarily be accomplished through the definition of § 225.2 of the revised regulation of the terms "bank," "commercial loans," "demand deposits," and "voting securities."

For purposes of the Bank Holding Company Act, a financial institution is deemed to be a "bank" if it both: "(1) accepts deposits that the depositor has a legal right to withdraw on demand *and* (2) engages in the business of making commercial loans. . . ." 12 U.S.C. § 1841(c) (emphasis added). Neither the BHCA nor the Board's current regulation define the terms used in either part of this two-pronged test. The Board now proposes to define both "demand deposits" and "commercial loans."

The Board proposes to define "demand deposits" in § 225.2(a)(1)(i) as "any deposit with transactional capability that as a matter of practice is payable on demand, and includes deposits accessible by check, draft, negotiable order of withdrawal, or other similar instrument." In our opinion, the proposed definition of demand deposits is unduly broad. In stating this view, the Office offers no comment on the inclusion of NOW accounts in the definition. That issue is likely to be decided in the pending litigation concerning the

Board's Order in First Bancorporation, 68 Fed. Res. Bul. 253 (1982).

However, the Office opposes the newly proposed definition because it is so broad as to apparently include accounts which, unlike NOW accounts, are not even arguably the equivalent of checking accounts. For example, the definition would appear to include the Money Market Deposit Account ("MMDA"). That account provides a transactional capacity that includes up to three checks per month. 12 C.F.R. § 1204.122(e). While depository institutions must reserve the right to require at least seven days' notice prior to withdrawal under 12 C.F.R. § 1204.122(d), checks drawn on the account are, in practice, payable on demand much like negotiable orders of withdrawal. However, unlike the NOW account, the MMDA is not: (1) the functional equivalent of a checking account, (2) advertised as such, or (3) subject to the same reserve requirements as a checking account.

In the First Bancorporation Order the above-enumerated characteristics were strongly relied on by the Board in finding the offering of NOW accounts to meet the first part of the BHCA's two part test of a "bank." The absence of these characteristics makes it clear that the MMDA is in essence a savings account rather than a checking account. At the meeting of the Depository Institutions Deregulation Committee at which the account was authorized, the authority for the MMDA was cited as the Garn-St Germain Depository Institutions Act, of course, rather than the laws authorizing demand deposit or NOW accounts. In discussing whether to allow more than three checks per month to be drawn against the MMDA, the Federal Reserve Board took the position that doing so would be tantamount to treating it as a demand deposit account. Such would be illegal, presumably because of the prohibition against paying interest on demand deposit accounts.

The MMDA was not intended to be considered a demand deposit account for purposes of the BHCA's definition of "bank." The proposed definition of "demand deposits" should be narrowed to exclude accounts such as the MMDA which are not equivalent to checking accounts.

FEDERAL DEPOSIT INSURANCE CORPORATION
Office of the Chairman

July 18, 1983

Honorable William W. Wiles
Secretary of the Board of Governors
of the Federal Reserve System
20th and Constitution Avenue, N.W.
Washington, D.C. 20551

Dear Mr. Wiles:

Subject: *Docket No. R-0470, Proposed Revision to Regulation Y*

We have reviewed the proposed revision to Regulation Y and are deeply concerned over the Board's attempt to resolve by regulation outstanding policy issues that are better left to Congress. The Board is attempting to resolve by regulation serious issues that will affect the entire financial industry. The Board's solution, however, can only serve as a stop-gap measure to a serious problem. As a consequence, we urge the Board to defer action on the proposal. Instead of rulemaking, a wiser alternative is to encourage Congress to immediately undertake a comprehensive review of problems arising from outdated statutory distinctions among banking institutions, thrifts, securities firms, other providers of financial services and commercial firms in general, and to enact permanent legislative solutions to these broad-based problems.

Sincerely,

/S/ Margaret L. Egginton
MARGARET L. EGGINTON
Deputy to the Chairman

UNITED STATES LEAGUE OF
SAVINGS INSTITUTIONS
WASHINGTON OFFICE
1709 New York Avenue, N.W., Washington, D.C. 20006
Tel. (202) 637-8900

July 18, 1983

Mr. William Wiles
Secretary to the Board
Board of Governors of the
Federal Reserve System
Washington, D.C. 20551

RE: Proposed Revision of Regulation Y (Docket No. R-0470)

Dear Mr. Wiles:

The U.S. League of Savings Institutions* wishes to take this opportunity to comment briefly on the proposal by the Board of Governors of the Federal Reserve System to revise its Regulation Y, which implements, *inter alia*, the Bank Holding Company Act of 1956, as amended (BHCA). Apart from the proposed codification in section 225.2(a)(i), (ii) of recent Board reinterpretations of the terms "demand deposit" and "commercial loan", we believe the proposal to be commendable.

Our primary concern with the definitions rests with their potential impact on state-chartered thrift institutions that do not have deposit insurance from the Federal Savings and Loan Insurance Corporation (FSLIC). Many of these institutions, proceeding in a legal environment in which the definitions of demand deposit and commercial loan have been reasonably stable, have become included within holding companies that engage in activities, particularly in the real estate area, that, while authorized under state law, do not comport with the requirements of Regulation Y. Under the Board's proposal, by the mere act of offering NOW accoounts and investing in commercial paper or certificates of deposit, they would find themselves defined, willy-nilly, as bank subsidiaries of bank holding companies, and, presumably, their parents could be forced to stop engaging in nonbanking activities impermissible under Regulation Y. In addition, it appears that proposed section 225.4(c), by its terms, would operate to compel such institutions to obtain deposit insurance from the Federal Deposit Insurance Corporation (FDIC), a task of very uncertain legality under section 3(a) of the Federal Deposit Insurance Act for thrifts not organized as savings banks.

* The U.S. League of Savings Institutions, formerly the U. S. League of Savings Associations, has a membership of 3,500 companies representing over 99% of the assets of the $730 billion savings and loan businesses. League membership includes all types of institutions—federal and state-chartered, stock and mutual. A number of savings banks are also members. The principal officers include: Leonard Shane, Chairman, Huntington Beach, CA; Paul Prior, Vice Chairman, New Castle, IN; William B. O'Connell, President, Chicago, IL; Roy G. Green, Executive Vice President and Washington Director; and Rita Fair, Vice President, Regulatory Operations. League headquarters are at 111 East Wacker Drive, Chicago, IL 60601. The Washington Office is located at 1709 New York Avenue, N.W., Washington, D.C. 20006. Telephone: (202) 637-8900.

We are confident that the Board does not contemplate precipitating the very substantial disruptions that would accompany a mechanical application of its proposal. While the interpretations upon which the proposed codification is based reflect a clear determination by the Board to apply the BHCA broadly to the activities of companies owning FDIC-insured commercial banks, we detect in them no impulse toward wholesale application of the BHCA and its restrictions to state-chartered thrifts controlled by companies not affiliated with such banks. Indeed, those interpretations show an acceptance of the fact that an institution may engage to some degree in making commercial loans and offering NOW accounts without triggering BHCA coverage.

For instance, in its order in *First Bancorporation*, 68 Federal Reserve Bulletin 253, 254 (March 12, 1982), the Board stated that "[a]lthough savings and loan associations and savings banks ... offer NOW accounts, their lending activities historically have been concentrated in home mortgages and their commercial lending activities are generally quite limited. This and other facts persuade the Board that the activities of such institutions presently authorized by federal statute law generally do not constitute engaging in the business of making commercial loans, and that such institutions

are not "banks" for purposes of the [BHCA]." Although the Board in its December 3, 1982 ruling with respect to the Wilshire Oil Company of Texas, 1 Federal Reserve Regulatory Service 4-363.1, stated, in effect, that total exploitation of all the commercial-type lending authorities contained in title III of the Garn-St Germain Depository Institutions Act of 1982 by an institution having neither FSLIC insurance nor a charter from the Federal Home Loan Bank Board would define, as a practical matter, a commercial bank for BHCA purposes, we do not read that document as leading to the conclusion that the Board automatically will define as a bank any state-chartered, non-FSLIC-insured thrift statutorily capable of exercising powers paralleling those extended by title III. In our view, the ruling evidenced, with respect to the Garn-St Germain Act, an attitude favoring a BHCA coverage analysis based on the actual activities of the depository institution in question rather than its hypothetical statutory possibilities. Certainly, the Board's past experience with the applicants in that case and the fact that the subsidiary bank had a huge, existing commercial loan portfolio were central to the Board's determination that voluntary adherence to title III thrift powers would not justify an exemption from BHCA coverage for the depository.

We strongly suggest that, with respect to devising an appropriate test for determining under what circumstnces a state-chartered thrift without FSLIC insurance should fall under BHCA coverage, the Board employ the asset composition standard contained in section 408(n) of the National Housing Act. Section 408(n), enacted by section 335 of the Garn-St Germain Act, essentially states that a unitary savings and loan holding company must observe the activities restrictions applicable to a multiple savings and loan holding company, which are basically the same as those that must be followed by a bank holding company, if its subsidiary FSLIC-insured institution has an asset composition such that the depository fails to qualify as a domestic building and loan association under section 7701(a)(19) of the Internal Revenue Code. As a recently enacted Congressional directive in a directly-related area, we believe the section 408(n) approach has special merit.

With respect to the question of mandating FDIC insurance, we trust that the Board is not proceeding from a determination that all state-chartered thrifts that lack federal deposit insurance and that are in holding company structures must become FDIC-insured if they fall under the Board's expanded definition of the term bank. Such a determination, of course, properly should flow from Congress, not from a regulatory agency. We urge the Board to revise its proposal to remove any question about the ability of these institutions to remain outside the federal deposit insurance system, despite being controlled by other companies, provided they qualify under the aforementioned section 7701(a)(19) test as domestic building and loan associations. The proposal also should stipulate that, if federal deposit insurance is required, it may be obtained from the FSLIC, if otherwise permitted under the National Housing Act, and not just from the FDIC.

As a final matter, we must note that the definitions that are the source of our concern regarding the proposal appear far too aggressive. This is particularly true with respect to the redefining of commercial loan to include the issuance of commercial paper or certificates of deposit, or the deposit of interest-bearing funds. We seriously doubt that this sweeping approach has any real basis in Congressional intent, and suggest that the Board should consider scaling the definition back considerably. Likewise, the definition of demand deposit appears excessively broad. We seriously question, for example, the Board's apparent conclusion that a telephone billpayer account should be equated with a checking account for BHCA purposes. That billpayer accounts may be reserveable under Regulation D does not strike us as relevant, given the specialized concerns underlying the imposition of reserve requirements. As with the proposed definition of commercial loan, we are convinced that the Board's proposal regarding demand deposits has parted company with the intentions of Congress.

To conclude very briefly, the U.S. League is certain that the Board does not intend to disturb arbitrarily current arrangements in that small sector of the thirft industry populated by institutions not statutorily exempted from being defined as banks for BHCA purposes. By adopting the asset

composition test and making the other changes we have suggested, the Board would avoid any unnecessary interference with that sector, without sacrificing any legitimate concerns under the BHCA.

If you have any questions regarding our comments, please do not hesitate to contact us.

/S/ Rita I. Fair
RITA I. FAIR
Vice President
Regulatory Operations

RIF:bbb

KIRKLAND & ELLIS
A Partnership Including Professional Corporations
1776 K Street, N.W.
Washington, D.C. 20006

August 1, 1983

Mr. William W. Wiles
Secretary
Board of Governors of the
Federal Reserve System
20th Street & Constitution Avenue, N.W.
Washington, D.C. 20551

Re: Proposed Revision of Regulation Y Docket No. R-0470

Dear Mr. Wiles:

The undersigned represents the Dimension Financial Corporation, which proposes to purchase the shares of 31 national banks located in 25 states if the Comptroller of the Currency approves pending charter applications. The purpose of this letter is to comment on the Federal Reserve Board's proposed revision of Regulation Y, published on May 25, 1983, 48 Fed. Reg. 23520 (Docket No. R-0470).

The Board's proposed revision purports, pursuant to the Financial Regulation and Simplification Act of 1980, merely to clarify and simplify Regulation Y, 12 C.F.R. Part 225, which implements the Bank Holding Company Act of 1956 as amended ("BHCA"). As part of the revision, however, new definitions that go far beyond clarification and simplification are proposed for the statutory terms "demand deposits" and "commercial loans," which relate to the determination of which financial institutions are "banks" for purposes of the BHCA. Proposed § 225.2(a), 48 Fed. Reg. at 23521, 23538. Under the guise of clarification and simplification, the Board is attempting to amend and expand legislatively the carefully crafted Congressional definition of bank in the BHCA. Such an action would exceed the delegated authority of the Federal Reserve Board.

Each of the proposed definitions is contrary to the plain meaning of the terms as used in the BHCA, as well as to the Congressional purposes underlying the statute. Numerous

previous Board interpretations confirm the invalidity of the proposed definitions. Yet, the Board fails even to attempt to articulate a justification for its radical changes in position, or to make any effort to explicate the rationale for such an expansion of its authority under the BHCA.[1]

I. THE STATUTORY AND HISTORICAL BACKGROUND

Under the BHCA, "bank" is defined as "any institution organized under the law of the United States ... which (1) accepts deposits that the depositor has a legal right to withdraw on demand, and (2) engages in the business of making commercial loans." 12 U.S.C. § 1841(c). The existing Regulation Y defines various terms, including "bank," to have the same meanings as such terms are given in the BHCA. 12 C.F.R. § 225.1. Purportedly relying on its *Beehive* ruling,[2] the Board's proposed revision would define "demand deposits" as "any deposit with transactional capability that is paid on demand as a matter of practice" and explicitly incorporates within that definition "negotiable order of withdrawal" (NOW) accounts. 48 Fed. Reg. at 23521, 23538 (proposed § 225.2(a)(1)(i)). The Board further proposes, by reference to its letter to the FDIC with respect to the Dreyfus Corporation,[3] to define "commercial loans" as "any loan other than a loan to an individual for personal, household,

[1] The Board's Federal Register notice does not even acknowledge that its proposal would constitute a major rewrite of the BHCA. The Notice states that "[t]he Board requests comments on all aspects of the proposed revision of Regulation Y, including definitions of terms," 48 Fed. Reg. at 23520, but does not otherwise provide any information on the definitional changes. The section summarizing the revisions conclusorily and without explanation announces the new definitions, relying solely on references to the Board's Beehive ruling and Dreyfus letter, 48 Fed. Reg. at 23521. Indeed, even the Board's Regulatory Analysis includes not a single word of explanation or justification for, let alone a reasoned analysis of, these drastic definitional changes. *See* "A Regulatory Analysis of Proposals to Revise Regulation Y: 'Bank Holding Companies and Change in Bank Control,'" A-21 (May 1983).

[2] Beehive Financial Corporation, 68 Fed. Res. Bull. 253 (1982) (copy attached as Addendum A).

[3] Letter to William M. Isaac, Chairman of the FDIC, from William W. Wiles, Secretary, Federal Reserve Board (December 10, 1982) (copy attached as Addendum B). *See also* 1 F.R.R.S. 4-363.2.

family or charitable purposes," including such money-market activities as "purchase of commercial paper, certificates of deposit, bankers' acceptances, and similar money market instruments, the extension of broker call loans, the sale of federal funds, and the deposit of interest-bearing funds." 48 Fed. Reg. at 23521, 23538 (proposed § 225.2(a)(1)(ii)).

These proposed definitions conflict directly with the plain meaning of the statutory definition of bank in the BHCA and would effect an unwarranted expansion of the statute beyond the purposes intended by Congress. The BHCA was not intended to grant the Board plenary jurisdiction over inter-state financial institutions. Rather, since its initial passage in 1956, the Act has been intended solely to prevent further concentrations of commercial banking resources and to separate commercial banking and related activities from other commercial enterprises.[4] Twice, in 1966 and again in 1970, Congress narrowed the definition of bank to assure that its scope remained consistent with "[t]he purpose of the Act": *I.e.*, "to restrain undue concentration of control of commercial bank credit, and to prevent abuse by a holding company of its control over this type of credit for the benefit of its nonbanking subsidiaries."[5]

The Board's proposed definitions would exceed these limited purposes and would sweep into the Act's coverage financial institutions not involved in commercial banking, including many institutions previously determined to be outside the Act's reach. Neither the plain words of the statute, the statutory objectives expressed in numerous Congressional pronouncements, nor any rationale heretofore advanced by the Board supports such drastic revisions of the statutory definitions.

[4] S. Rep. No. 1095, 84th Cong., 1st Sess., *reprinted in* [1956] U.S. Code Cong. & Ad. News 2482, 2483.

[5] S. Rep. No. 1179, 89th Cong., 2d Sess. (1966), *reprinted in* [1966] U.S. Code Cong. & Ad. News 2385, 2391. *See* further discussion of the 1966 and 1970 amendments at pp. 9-10, 23-24 *infra*.

II. DEMANDS DEPOSITS AND NOW ACCOUNTS

The Board's attempt to define "demand deposits" to include NOW accounts constitutes an illegal expansion of the statutory term in the BHCA. Important functional differences exist between demand deposits and NOW accounts. Federal legislation, as well as previous Board rulings and actions, have long recognized these differences. And, the Board has advanced no reasoned or substantiated rationale for rejecting its traditional interpretations distinguishing such accounts.

A. NOW Accounts Are Functionally Distinguishable from Demand Deposits.

By attempting to define "demand deposits" to include NOW accounts, the Board obliterates the clear functional distinctions among these different types of transaction accounts. Nowhere in its Notice does the Board recognize these distinctions.

All applicable federal statutes and regulations provide that NOW privileges may be offered only in connection with savings deposit accounts, not demand deposit accounts or deposits payable on demand. NOW accounts offered by member banks (*i.e.*, NOW privileges plus savings deposits) are governed by the Board's regulations applicable to "savings deposit" accounts.[6] NOW accounts, unlike demand deposits, are available only to individuals, sole proprietorships and nonprofit organizations.[7] Federal law authorizes NOW privileges to be offered only in conjunction with interest-bearing

[6] 12 C.F.R. §§ 217.1(e) & 217.5. Under Regulation Q, a member bank may only have three types of mutually exclusive deposits: demand deposits, savings deposits, and time deposits. The same regulation specifically prohibits any member bank from paying interest on a demand deposit. 12 C.F.R. § 217.2(a). The Board's own regulations thus specifically distinguish NOW accounts from demand deposits.

[7] *See* 12 U.S.C. § 1862(a)(2); 12 C.F.R. § 217.1(e)(3). Congress added the demand deposit limitation because it believed that institutions that did not offer demand deposits would not be involved in commercial banking. *See* note 5 *supra* and accompanying text. Since NOW accounts cannot be used by corporations, the availability of such accounts will not generate significant commercial banking business for an institution.

accounts—no interest may be paid on "demand deposit" accounts.[8] A federally insured depository institution has the right to require notice before withdrawal from a NOW account[9]—the same right is not present with respect to demand deposits.

These functional differences between demand deposits and NOW accounts exist today and have been recognized by both Congress and the Board in the past, as described below.

B. Congress Has Consistently Distinguished Between Demand Deposits and NOW Accounts.

Congress has consistently distinguished between demand deposits and NOW accounts. The original 1956 BHCA defined bank broadly to include "any national banking association or any State bank, savings bank, or trust company."[10] But, following two controversial Board decisions holding that an industrial bank would be subject to the BHCA if it "accepts deposits subject to check . . . that are in actual practice, repaid on demand,"[11] Congress added the payable on demand requirement to the BHCA definition of bank. The amended statute thus emphasized through precise statutory language that institutions were banks only if their "depositor has a legal right to withdraw on demand." The Board fully supported this amendment:[12]

[8] 12 U.S.C. § 1832(a)(1).

[9] That this right may not often be exercised does not obviate the significance of its existence. The BHCA defines a "bank" as "any institution . . . which (1) accepts deposits that the depositor has a *legal right* to withdraw on demand." 12 U.S.C. § 1841(c) (emphasis added). The Board's attempt to include within "demand deposits" deposits "paid on demand *as a matter of practice*" thus conflicts squarely with the plain words of the statute. *See* 48 Fed. Reg. at 23521 (emphasis added). Although the *Wilshire* court permitted the Board some latitude to expand the meaning of "demand deposits" beyond the literal words of the statute to reach a sham transaction in a specific circumstance, *see Wilshire Oil Co.* v. *Board of Governors*, 668 F.2d 732, 738 (3d Cir. 1981), *cert. denied*, 102 S.Ct. 2958 (1982), the opinion cannot be read to authorize a general contravention of the statutory requirements.

[10] Act of May 9, 1956, ch. 240, § 2(c), 70 Stat. 133.

[11] Applicability of the Bank Holding Company Act to Industrial Banks, 49 Fed. Res. Bull 165-66 (1963); Industrial Banks as "Banks" under the Bank Holding Company Act, 51 Fed. Res. Bull. 1539-40 (1965).

[12] Hearings on S. 2353, S. 2418, and H.R. 7371 Before a Subcomm. of

> The Board believes that the definition should be amended to cover only "an institution that received deposits payable on demand," thereby limiting coverage to commercial banks (i.e., banks that offer checking accounts), and excluding not only industrial banks but other savings banks that accept funds from the public that are paid on demand. ... [W]e see no reason in policy to cover such institutions under this act.

Both Congress and the Board thus fully recognized in 1966 the crucial distinction between accounts, such as NOW accounts, that may "in practice [be] repaid on demand" and demand deposits legally required to be "paid" on demand. Both agreed that financial institutions that had the latter type of accounts were banks that should be subject to the BHCA, but institutions with the former type of accounts should not.

Congressional recognition of these distinctions was evident when NOW accounts were initially created. A bill permitting the payment of interest on demand deposit accounts was introduced and rejected in 1979.[13] In its place, Congress enacted the Depository Institutions Deregulation and Monetary Control Act of 1980 ("DIDA"),[14] which permitted NOW accounts. Had Congress viewed NOW accounts as the functional equivalent of paying interest on demand deposits, it could have simply enacted the proposed bill. It did not.

Enactment of the Garn-St. Germain Depository Institutions Act of 1982 evidenced continued Congressional recognition of the difference between NOW accounts and demand deposits.[15] That bill permitted federal savings and loan associations, which already had authority to accept NOW accounts, also to accept "demand accounts," but prohibited payment of interest on such accounts.[16] The Senate Report accompanying the bill underscored the differences between the two types of accounts:[17]

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the Senate Comm. on Banking & Currency, 89th Cong., 2d Sess. 447 (April 20, 1966, letter of the Board of Governors).

[13] H.R. 3864, 96th Cong., 1st Sess. (1979).

[14] Pub. L. No. 96-221, 94 Stat. 133 (1980).

[15] Pub. L. No. 97-320, 96 Stat. 1469 (October 15, 1982).

[16] Garn-St. Germain Act, § 312 (to be codified at 12 U.S.C. § 1464(b)).

[17] S. Rep. No. 536, 97th Cong., 2d Sess. 15 (1982) (emphasis added).

> Demand accounts may be accepted from persons or organizations that have established a business relationship with the thrift institution; whereas, federal thrifts may now offer *only NOW* accounts ... the intent of this provision is to permit all federal thrift institutions to offer *checking accounts* to their commercial lending customers. This allows the maintenance of a *demand deposit* even though a business customer with a credit relationship occasionally may not have an outstanding loan.

Congress has carefully distinguished between NOW accounts and demand deposits in legislation dealing with the two types of deposits. Thus, the distinction has been maintained, consistent with the 1966 amendment to the BHCA, between deposits legally required to be paid on demand (demand deposits) and deposits (such as NOW accounts) not legally required to be so paid, even if in practice such accounts are typically paid on demand. Yet, the proposed Regulation Y proposal seeks to obliterate the line between NOW accounts and demand deposits without any discussion by the Board in its Federal Register Notice of this consistent legislative direction.

C. The Board Has Consistently Distinguished NOW Accounts from Demand Deposits.

Consistent with its 1966 position that demand deposits under the BHCA do not include accounts "paid," although not "payable" on demand, the Board and its staff have consistently acknowledged that NOW accounts are not demand deposits. This distinction is clearly set forth by Pauline Heller, former Assistant General Counsel to the Board.[18] Ms. Heller notes that although NOW and other savings accounts "are, as a matter of practice, paid on demand," such deposits "are *not* demand deposits for purposes of the [BHC] Act, because the depository institution is not obliged as a matter of legal right to pay a withdrawal request (or NOW) upon presentation."

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[18] *Handbook of Federal Bank Holding Company Law* 6-7, n.21 (1976).

The Board honored this distinction as recently as 1981. In the course of rejecting Wilshire Oil Company's attempt to avoid being required to divest the Trust Company of New Jersey (TCNJ) by nominally instituting a notice requirement for demand deposits while simultaneously announcing it did not intend to require notice, the Board noted once again the distinctions between saving deposits with NOW privileges and demand deposits:[19]

> [W]hile Congress had authorized depository institutions to permit withdrawals from *savings accounts* by means of negotiable orders (checks), only individuals and certain not-for-profit organizations may exercise such rights. Pub. L. No. 96-221, § 303, 94 Stat. 146. The Board's regulations provide that any deposit (whether or not interest-bearing) held by a for-profit organization that may be accessed by a negotiable order is not a *savings deposit.* 12 C.F.R. § 217.1(e)(3).... Thus, because TCNJ's transaction accounts are offered to for-profit corporations and other organizations and because TCNJ permits withdrawal from such accounts by negotiable order, the transaction accounts are not "*savings accounts*" under the relevant regulations and are "*demand deposits*" under such regulations.

In its brief to the Third Circuit—which was successful in obtaining affirmance of the Board's decision delcaring Wilshire's TCNJ subsidiary a bank—the Board carefully set forth the basis upon which it had traditionally distinguished NOW accounts from demand deposits. After noting that the FRB and FDIC had traditionally defined demand deposits as deposits that were neither time nor savings deposits, and that Congress had recently permitted individuals and not-for-profit organizations to make withdrawals from interest-bearing savings deposits through NOW accounts, the Board argued to the Court that Wilshire's non-interest-bearing accounts, available to profit-organizations, with an explicitly stated non-binding 14-day withdrawal notice requirement, were demand deposits.[20] The brief further emphasized the

[19] *In re Wilshire Oil Co.*, Fed. Res. Bd. Dkt. No. 1114026, at 14-15 (April 2, 1981) (Final Decision and Order) (emphasis added).

[20] Brief for the Board in No. 81-1560 (June 25, 1981) at 9, 38-41; *see also* Wilshire Oil Co. v. Board of Governors, 668 F.2d 732, 737 n.10 (3d Cir. 1981), *cert. denied*, 102 S. Ct. 2958 (1982), accepting these distinctions.

Board's long-standing view that NOW accounts are not demand deposits even though "financial institutions [with NOW accounts to which advance notice of withdrawal requirements apply] do not normally exercise that right."[21]

Consistent with its long-standing position that NOW accounts are not demand deposits, the Board in several recent instances has permitted bank holding companies to acquire under Section 4(c)(8), as non-bank acquisitions, institutions that both made commercial loans and accepted NOW accounts.[22] With no indication that the lending activities of these institutions fell outside of the meaning of "engaged in the business of making commercial loans," these approvals can only be interpreted as having been predicated on the conclusion that NOW accounts are not demand deposits within the meaning of the BHCA.

The proposed Regulation Y revision of the term "demand deposits" to include NOW accounts thus marks a substantial departure from past, consistent Board positions. Such redefinition goes well beyond any mere "simplification and clarification" of the Board's regulations.

D. The Board Has Advanced No Articulated or Substantiated Basis for Its New Definition of Demand Deposits.

The Board's Federal Register Notice provides no rationale for adoption of its new definition of "demand deposits." To the contrary, the Board merely states that it is "incorporat[ing] Board interpretations of the past," and then cites but one such prior interpretation, its ruling concerning Beehive Financial Corporation. 48 Fed. Reg. at 23521.

[21] *Wilshire* Brief by the Board, *supra* note 20, at 44, n.67.

The Board's position in *Wilshire* reiterated the position it had taken in its earlier brief in United States League of Savings Associations v. Board of Governors, No. 78-2206, U.S. Court of Appeals for the District of Columbia, Brief at 28, 29 n.17:

> The fact that banks might not invoke their right [to demand notice] does not vitiate the distinction between demand and savings deposits, just as it did not in 1913, when Congress statutorily distinguished between these deposits on such basis.

While the Board's views were rejected by the Court, Congress subsequently enacted legislation confirming the prohibition on interest payments on demand deposits that the Board had argued for in this case.

[22] *See, e.g., Heritage Bank*, 66 Fed. Res. Bull. 590 (1980); *First Financial Corporation of New Hampshire*, 66 Fed. Res. Bull. 594 (1980).

As already noted, the Beehive decision marks a 180 degree reversal of past Board decisions. Although the Board claims in that ruling that NOW accounts are demand deposits because the notice requirement is "rarely invoked," and "in practice the customer is permitted to withdraw funds on demand"[23] it had consistently argued to the contrary in the *Wilshire* case and in prior interpretations of the BHCA. Similarly, the Board's claim in Beehive that passage of the DIDA of 1980, which, *inter alia*, subjected NOW accounts to reserve requirements, evidenced a Congressional recognition that NOW accounts should be considered demand deposits, is again belied by its position in Wilshire that demand deposits and NOW accounts were clearly distinguished *in that Act.*[24]

Despite its radical changes in position in the Beehive ruling, the Board put forward not a single word of explanation to justify its departure from established precedent (indeed, its implies no such change has occurred). At best, the only rationale for the new definition can be found in the Board's vague and conclusory claim that there is a "potential for evasion of the Act associated with NOW accounts."[25] What purposes of the BHCA[26] will be evaded in what manner is a question for which the Board proffers no answers, let alone

[23] Beehive Ruling, *supra* note 2, 68 Fed. Res. Bull. at 253.

[24] *Wilshire* Brief, by the Board, *supra* note 20, at 7-8.

[25] Beehive ruling, *supra* note 2, 68 Fed. Res. Bull. at 254.

[26] In *Beehive*, the Board further argued that NOW accounts must be treated as demand deposits so that the Board could, by means of the BHCA enforce reserve requirements against Beehive, which was not federally insured. *See* Beehive Ruling, *supra* note 2, 68 Fed. Res. Bull. at 254-55. The BHCA, however, is concerned with limiting the relationship of banking and commerce, *see* notes 4-5, 12 *supra* and accompanying text. Augmenting Board control over the money supply is not one of its purposes.

In 1980, DIDA extended reserve requirements to any transaction accounts (including NOW accounts) maintained by FDIC-insured banks. Congress thus determined the limits of reserve requirements, and it is clearly improper for the Board to seek to circumvent those limits through the application of the BHCA. Moreover, without any empirical support, it is unreasonable for the Board to assume that the small percentage of uninsured institutions that offer NOW accounts will have any material impact on the money supply.

any evidence that any such practices are threatened anywhere in the United States today. One can only conclude that the Board is relying on the circular reasoning that evasion exists because the Board says it exists. In fact, the absence of any legislative or factual rationale for including NOW accounts as demand deposits suggests to the contrary.

* * * * *

In sum, the Board's attempt through a "clarifying" amendment to expand the definition of demand deposits beyond the clear statutory words of the BHCA and beyond any expressed Congressional intent cannot stand scrutiny. The Board's Federal Register Notice does not even attempt to articulate or substantiate the basis for such expansion of its delegated authority. The proposal to revise Regulation Y to include NOW accounts within the definition of demand deposits should be reconsidered by the Board and rejected.

III. COMMERCIAL LOANS

Just as it has attempted to bootstrap a single unsupported interpretation of "demand deposits" to general regulatory status through its proposed new Regulation Y, the Board proposes to amend the definition of "commercial loan" by reference to a single prior Board statement. The Federal Register Notice again provides no rationale for the new definition, again indicates it is merely "incorporat[ing] Board interpretations," and again cites but one such statement, a letter to the Chairman of the FDIC. 48 Fed. Reg: at 23521. As the FDIC (as well as the Comptroller of the Currency) stated in response to that letter, no such expanded definition of commercial loans can be supported by law or logic. Such expansion would violate the plain words of the BHCA and serve no Congressional purpose expressed in that Act.

A. The Board's Proposed New Definition of Commercial Loans Would Violate Specific Congressional Directions and Conflicts Directly with Numerous Past Board Precedents.

The proposed Regulation Y definition of commercial loans to include within the term, *inter alia*, "commercial paper, certificates of deposit, bankers acceptances, and similar money market instruments," would incorporate the Board's position expressed in its December 10, 1982 letter concern-

ing the Dreyfus Corporation's acquisition of the Lincoln State Bank.[27] The radical departure evidenced by the Board in its proposed new definition of commercial loans has been noted by authorities no less expert than the Federal Deposit Insurance Corporation and the Comptroller of the Currency. Responding to the Board's December 10 letter, the Comptroller termed the Board's position "an abrupt and profound departure from the Board's past interpretations of the BHCA term 'commercial loan.'"[28] The FDIC agreed:[29]

> Heretofore, the Federal Reserve Board's analysis of what constitutes a commercial loan has focused on direct lending activities and has not suggested that the entire spectrum of money market activities and interbank transfer of funds should be incorporated into the concept.

Thus, continued the FDIC, by "dramatically re-cast[ing] the definition of commercial loan," the Board has made a "radical departure from the traditional view of what constitutes a commercial loan [that] raises issues *beyond the scope of regulatory interpretation.*]" Such radical policy changes, concluded the FDIC, "should be brought about by Congressional, *not agency,* action."[30] The FDIC therefore determined not to disapprove the Dreyfus proposal despite the Board's opposition precisely because "the FDIC was constrained to follow the clear legal precedents established over the years."[31]

Those "clear legal precedents" begin with the enactment of the commercial loan limitation itself. Congress added the provision in 1970 to avoid subjecting to the BHCA "institutions which are not in fact engaged in the business of commercial banking in that they do not make commercial

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[27] Dreyfus Letter, *supra* note 3.

[28] Comptroller Decision to Charter Dreyfus National Bank & Trust Company, 40 Washington Financial Rep. 308, 310 (1983) (copy attached as Addendum C).

[29] Letter from Margaret L. Egginton, Deputy to the Chairman, FDIC, to William W. Wiles, Secretary, Federal Reserve Board (Dec. 29, 1982) (copy attached as Addendum D).

[30] *Id.* (emphasis added).

[31] *Id.*

loans."[32] Although the narrowing of the definition of "bank" may have been prompted by the case of one trust company, Boston Safe,[33] as the Comptroller has noted, "it is clear that the narrowing ... was not intended to be applicable only to Boston Safe" because "Congress did not intend the exemption ... to be so restrictively interpreted as to subject to the BHCA those financial institutions which need not be subject ... to effect that Act's purpose."[34]

Accordingly, in 1972, the Board determined that Boston Safe was not making "commercial loans" for purposes of the BHCA when it sold federal funds and purchased certificates of deposit, commercial paper, and bank acceptances.[35] A 1981 Board inter-office memorandum noted explicitly that in its Boston Safe decision, "[t]he Board ... concluded that, although commercial in nature, the purchase of federal funds, money market instruments (certificates of deposit, commercial paper, and bankers acceptances) are not considered commercial loans *for the purposes of section 2(c) of the Act,* despite the fact that for other statutory and regulatory purposes these instruments may be considered commercial loans."[36]

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[32] S. Rep. No. 1084, 91st Cong., 2d Sess. (1970), *reprinted in* [1970] U.S. Code Cong. & Ad. News 5519, 5541.

The Board argues in its Dreyfus Letter, *supra* note 3, at 2, that the term "commercial loans" was to be "very narrowly applied", based on the tautological statement of the House Managers that "the Board should interpret [this] exemption[ ] as narrowly as possible in order that all bank holding companies which should be covered under the Act in order to protect the public interest will, in fact, be covered." H.R. Rep. No. 1747, 91st Cong., 2d Sess. 23 (1970). The amendment was first offered in the Senate, however, and the quotation in the text above from the Senate Committee Report authoritatively confirms that the only institutions "which should be covered" are those "engaged in the business of commercial banking," as that term has been traditionally used. *See* 116 Cong. Rec. 42422 (1970)

[33] *See* 116 Cong. Rec. 25848 (1970).

[34] Comptroller's Dreyfus decision, *supra* note 28, 40 Washington Financial Rep. at 311.

[35] Letter to Lee J. Aubrey, Vice President, Federal Reserve Bank of Boston, from Michael A. Greenspan, Assistant Secretary, Federal Reserve Board (May 18, 1972) (copy attached as Addendum E).

[36] Office Correspondence of February 10, 1981, at 3 (emphasis in original) (copy attached as Addendum F, released pursuant to an FOIA request to the Board with Board masking as shown).

Since *Boston Safe*, the Board has consistently followed the determination that "commercial loans" as used in the BHCA do not include money market instruments such as broker call loans,[37] or investments in government securities, SBA loans and FHA loans.[38] Recent acquisitions by Gulf & Western, Household Finance Corp., and Citicorp involved institutions that offer NOW accounts and whose financial activities include participation in transactions which would be "commercial loans" under the Regulation Y proposal[39]—yet the Board either approved these acquisitions or took no action to prevent them.[40]

In the Gulf & Western and Household Finance cases, the Board recognized that divestiture of commercial loan portfolios would fully accomplish the BHCA purpose of separating commercial banking from commerce. As the Third Circuit noted in *Wilshire*, the Board's approval of Gulf & Western's

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[37] *See, e.g.*, Letter to Michael A. Greenspan from Baldwin B. Tuttle, Deputy General Counsel, Federal Reserve Board (January [illegible] 1976) (unpublished) (broker call loans do not constitute commercial loans) (copy attached as Addendum G).

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[38] Letter to William N. McDonough, Assistant General Counsel, Federal Reserve Bank of Boston, from Robert E. Mannion, Deputy General Counsel, Federal Reserve Board (November 13, 1980) (unpublished) (investment in government securities, SBA loans, and FHA loans does not constitute "making commercial loans") (copy attached as Addendum H).

It should be noted that because the Board defines "commercial loans" by exclusion ["all loans except . . ."], investments in such obviously noncommercial instruments as government securities arguably come within the definition.

[39] Both Associates National Bank and Valley National Bank—acquired by Gulf & Western and Household Finance, respectively—dealt in Treasury and other government securities and sold federal funds. *See* Bank Administration Institute, *Innerline*, Index of Bank Performance—Individual Bank Profile (1982) (Associates and Valley profiles attached as Addendum I). Although confirmation is not available on the S&L acquired by Citicorp, S&L's routinely engage in money market activities and absent evidence to the contrary, it must be assumed that Citicorp's S&L engaged in such activities. *See* notes 43-44 *infra* and accompanying text.

[40] *See American Banker*, Mar. 13, 1981, at 26 (Gulf & Western) (copy attached as Addendum J); *American Banker*, July 13, 1981, at 1 (HFC) (copy attached as Addendum K); *American Banker*, Sept. 30, 1982, at 4 (Citicorp) (copy attached as Addendum L); *American Banker*, October 4, 1982, at 4 (Citicorp Appendix) (copy attached as Addendum M).

acquisition of Fidelity National Bank, accompanied by divestiture of FNB's commercial loan portfolio, created a situation where "there was no longer the same danger of the abuses related to commercial banking that the BHC Act was designed to prevent."[41]

Indeed, even in the Beehive decision in March 1982, the Board continued to honor its consistent position on the definition of commercial loans. The Board there recognized that savings and loan associations and savings banks (which would accept demand deposits if NOW accounts were included as such) should still not be considered "banks" under the BHCA, as "their commercial lending activities are generally quite limited."[42] Yet, at the time of the decision, a S&L could invest an unlimited percentage of its assets in such instruments as certificates of deposits and other interbank trading vehicles, government securities, and certain types of broker call loans, and could invest up to 20% of its assets in commercial paper[43]—all of which transactions the Board now claims constitute "commercial loans."

Similarly, in the Citicorp case, the Board determined that "a federally insured savings and loan association that offers NOW accounts and *exercises no greater commercial lending powers than are now permitted* to a federal savings and loan association . . . is not a 'bank' for purposes of the BHC Act."[44] Since a S&L's "lending powers" include the unlimited ability to purchase several types of money market and interbank instruments, the Board evidently viewed such activity as not entailing "commercial lending powers."[45] Thus, barely two months before the Dreyfus letter, the Board was still treating the term "commercial loans" as not including such money market activities.

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[41] *Wilshire Oil*, 668 F.2d at 739 n.15.

[42] Beehive Ruling, *supra* note 2, 68 Fed. Res. Bull. at 254 n.5.

[43] *See* 12 U.S.C. § 1464(c) (1976) (amended 1982).

[44] Citicorp Ruling, *American Banker*, October 4, 1982, at 14 (emphasis added).

[45] The Board also noted that the acquired S&L had 6% of its assets in commercial real estate loans, but did not mention the value of the S&L's money market activities, thus indicating that such activities were not of concern.

The Board's consistent pattern of decisions followed a course mandated by the plain words of the BHCA. Neither the statute nor its legislative history in any way suggest that the term "commercial loans" was intended to extend beyond its traditional meaning. Moreover, regulation of financial institutions which engage in money market activities for asset/liability management purposes is not necessary under the BHCA, because such institutions pose no threat of concentration of commercial banking resources nor of abuse of commercial banking power through the mixing of banking and commerce. As the Comptroller emphasized:[46]

> [T]here are serious questions as to whether any of the money market activities mentioned in the Board's December 10 letter are commercial loans for purposes of the BHCA. All those money market activities involve only very short term funding commitments by the banks involved. They are an essentially passive medium of investment, are reviewed on a very frequent basis, and do not involve a close lender-borrower relationship. For these reasons, the subject money market activities have little potential of involving the types of commercial lending abuses which Congress wished to prevent through the BHCA.

Stated simply, support for the Board's attempt to reverse its long-standing definition of "commercial loans" cannot be found (and has not been found by either the FDIC or the Comptroller) in the plain words of the BHCA nor implied from the Congressional purposes lying behind the statute.

B. The Board Has Advanced No Articulated or Substantiated Basis for Its New Definition of Commercial Loans.

The Board's abrupt about-face on the meaning of "commercial loans" and its revisionist readings of its previous statements on the subject cannot obscure the incorrectness of interpreting the term to apply to money market activities. Other than unsupported conclusory pronouncements in its referenced December 10, 1982, letter, the Board provides no

[46] Comptroller's Dreyfus decision, *supra* note 28, 40 Washington Financial Rep. at 311.

reason for its new definition of commercial loans in its Federal Register Notice.

The Board's purported rationale—to prevent non-bank banks without commercial loan activities from presenting "a potential for evasion of the purposes of the BHC"—is circular reasoning at best. If such financial institutions were not intended by Congress to be banks subject to the BHCA, there can be no evasion of any Congressional purposes. As noted by the Comptroller,[47] money market and related activities are not commercial loans as that term is normally understood; the Board makes no attempt to demonstrate factually that its regulation of institutions engaged in the former is necessary to prevent abuse of the latter, or even that the two are related in purpose or effect.[48]

The Board attempts to buttress its evasion rationale, again without any factual discussion, by conclusorily announcing that "the proliferation of . . . acquisitions would allow for the expansion of banking across state lines without either state authorization or Congressional approval."[49] The Board's claim at this late date that activities "during the past year"[50] have necessitated drastic revisions of the definition of commercial loans to foreclose the purported evil of insterstate banking severely strains its credibility. To begin with, interstate banking as a general proposition is not prohibited by the BHCA. Indeed, it has flourished for many years under the approval and active encouragement of the Board. The Federal Reserve Bank of Atlanta recently sur-

[47] *See* note 46 *supra* and accompanying text.

[48] Regulation Y itself belies the Board's claimed concerns regarding the possibility of banking and commerce intermingling through money market activities. Section 225.23(b)(3)(iii) permits trust companies to "[make] call loans to securities dealers or purchas[e] money market instruments such as certificates of deposit, commercial paper, government or municipal securities, and bankers acceptances." 48 Fed. Reg. at 23543. These activities, which are termed part of the "traditional activities carried on by trust companies generally," *id.* at 23531, are thus determined to be "nonbanking activities" but are considered a "proper incident" to banking under Section 4(c)(8) of the BHCA. *See id.* at 23530; 12 C.F.R. § 225.4(a)(4) (1983).

[49] Dreyfus Letter, *supra* note 3, at 3.

[50] *Id.* at 3.

veyed the extent of interstate banking activity and concluded simply, "the fact is that banking organizations are providing financial services across state lines and have been doing so for some time."[51] The Atlanta Fed found that "domestic banking organizations control at least 7,383 interstate offices and, if we include interstate offices of foreign banking organizations the total reaches 7,840."[52] As this survey makes clear, interstate banking cannot be considered a new phenomenon justifying radical new definitions of the BHCA.

Indeed, the Board's claim to be concerned with "proliferation" and the "expansion of banking across state lines," conflicts directly with its proposed revision of Regulation Y to permit additional unreviewed expansion. Section 225.25(a)(2) of the proposal would significantly reduce barriers to expansion of existing interstate activities, *see* 48 Fed. Reg. at 23533, 23545, and the Board is even "considering whether to eliminate the requirement for state-by-state approval for *de novo* expansion" across state lines. *Id.* at 23533.

Congress' recent action allowing Federally chartered savings and loans to offer demand deposit accounts and to make conventional commercial loans, while at the same time emphasizing that such expanded-power S&L's are not "banks" under the BHCA further belies the Board's contention that any evasion of the Act would occur absent its new definitions.[53] Congress has recognized that no evasion of the purposes of the BHCA—preclusion of commercial bank concentration and maintenance of the separation of banking and commerce—occurs even when savings and loans engage in both activities that statutorily define banks.[54]

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[51] Whitehead, Interstate Banking: Taking Inventory, May 1983, *Economic Review*, at 4 (copy attached as Addendum N).

[52] *Id.* at 18. A recent study by Synergistics similarly documents the pervasiveness of interstate banking throughout the United States. *See* Synergistics Research Corporation, *Interstate Banking Directory* (April 1, 1983).

[53] The Garn-St. Germain Depositary Institutions Act of 1982, Pub. L. No. 97-320, §§ 312 and 325 (October, 1982), grants S&L's these expanded powers. *See* S. Rep. No. 536, 97th Cong., 2d Sess. 55 (1982) (such institutions are intended not to be subject to the BHCA).

[54] *See* notes 43-44 *supra* and accompanying text.

Finally, the proposed redefinition of commercial loan would have severe ramifications for existing institutions whose status would be changed from nonbanks to banks. For example, many industrial bank subsidiaries of registered bank holding companies offer NOW accounts and routinely participate in the money markets. The Board approved the acquisition of these institutions as nonbanks under Section 4(c)(8) of the BHCA. Under the expanded definitions of demand deposit and commercial loan now being proposed, these holding company affiliates would have to meet the standards of Section 3 of the Act or be divested. Moreover, state chartered savings banks would also become "banks" subject to the BHCA if Regulation Y is amended as the Board proposes. These banks, of course, have not been subject to regulation by the Board since 1966, and to effect a reversal of the 1966 decision to exclude savings banks—which was supported by the Board[55]—requires an act of Congress, not simply the amendment of a Board regulation.

In sum, as with its attempt to amend the definition of demand deposits, the Board is attempting to expand vastly its definition of commercial loans without even advancing an articulated rationale for or substantial evidence to support such expansion. Such drastic reversal of past Board precedent, inconsistent with both the statutory words and Congressional intent, cannot be justified. The Board should reconsider its proposed redefinition and delete it prior to final promulgation of Regulation Y.

CONCLUSION

The BHCA has the limited purpose of separating commercial banking and commerce, a purpose fully accomplished through interpreting "demand deposits" and "commercial loans" as those terms were intended by Congress and have been traditionally employed by the Board. The Board's abrupt and illogical expansion of those terms can serve no purpose other than administrative aggrandizement. The Board's

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[55] *See* note 12 *supra* and accompanying text.

proposed definitions cannot be justified by the words of the statute, Congressional intent, or past practice. The Board should not adopt the proposed definitions.

Respectfully submitted,

/S/ Timothy S. Hardy
TIMOTHY S. HARDY
Counsel to Dimension Financial Corporation

ADDENDUM A

First Bancorporation,
Salt Lake City, Utah

Order Conditionally Approving Acquisition of an Industrial Loan Company

First Bancorporation, Salt Lake City, Utah, a bank holding company within the meaning of the Bank Holding Company Act, has applied for the Board's approval under section 4(c)(8) of the act (12 U.S.C. § 1843(c)(8)) and section 225.4(a) of the Board's Regulation Y (12 C.F.R.§ 225.4(a)(2)) to acquire Beehive Financial Corporation ("Beehive Financial") and its wholly-owned subsidiary, Beehive Thrift and Loan Company, Salt Lake City, Utah ("Beehive Thrift"), an industrial loan company. Applicant proposes to engage in lending, industrial loan, leasing, and credit-related insurance activities. These activities have been determined by the Board to be closely related to banking. (12 C.F.R. §§ 225.4(a)(1), (2), (6)(a), and (9)(i)(a)). Industrial loan companies were recently authorized under Utah law to offer NOW accounts, and Applicant also proposes to engage in this activity.

Notice of the application, affording opportunity for interested persons to submit comments has been duly published (46 *Federal Register* 54801). The time for filing comments has expired, and the Board has considered the application and all comments received in light of the factors set forth in section 4(c)(8) of the act.

Applicant, the 31st largest banking organization in Utah, controls one bank with total deposits of about $14.7 million, representing less than 0.5 percent of the total deposits in commercial banks in that state, and 0.5 percent of deposits in the Salt Lake City banking market.[1]

Beehive Financial and its subsidiary, Beehive Thrift, have consolidated assets of $3.3 million and liabilities of $2.8 million, including $2.3 million in deposits. In view of the size of the companies involved, the Board concludes that no adverse competitive effects would be associated with this proposal.

Under section 4(c)(8) of the act, the Board is authorized to permit bank holding companies to acquire shares of any com-

[1] Banking data are as of June 30, 1980.

pany the activities of which the Board has determined to be "so closely related to banking or managing or controlling banks as to be a proper incident thereto." In determining whether a particular activity is a proper incident to banking or managing or controlling banks, the Board is required to consider whether performance of the activity by a bank holding company can reasonably be expected to produce benefits to the public, such as greater convenience, increased competition, or gains in efficiency, that outweigh possible adverse effects, such as undue concentration of resources, decreased or unfair competition, conflicts of interests, or unsound banking practices.

The Board has previously determined that the activity of operating an industrial loan company in the manner authorized by state law is closely related to banking, "so long as the institution does not both accept demand deposits and make commercial loans." (12 C.F.R. § 225.4(a)(2)). An institution engaging in both activities would be regarded as a "bank" for purposes of the act. Section 2(c) of the act defines as a "bank" any institution that "accepts deposits that the depositor has a legal right to withdraw on demand, and engages in the business of making commercial loans." (12 U.S.C. § 1841(c)). The acquisition of a bank in subject to approval under section 3 of the act rather than section 4.

The offering of NOW accounts by an industrial loan company raises a question of whether an institution that offers such accounts and engages in the business of making commercial loans is a "bank" within the meaning of section 2(c) of the Bank Holding Company Act. Institutions that offer NOW accounts generally reserve the right to require 14-30 days' notice before permitting withdrawals from these accounts. The notice requirement is rarely invoked by institutions offering NOW accounts, however, and in practice the customer is permitted to withdraw funds on demand by check or draft. Indeed, for purposes of section 2(c), the Board believes that, until the institution invokes the notice requirement, the depositor has a right to withdraw funds on demand. Moreover, in giving meaning to the demand deposit portion of the definition of "bank", the court in *Wilshire Oil Company of Texas* v. *Board of Governors* (3d Cir. 1981)

(filed December 31, 1981), ruled that in using the words "deposits that the depositor has a legal right to withdraw on demand," Congress was concened with the substance rather than the form of the deposit. (Slip Op. at 10-11).[2]

The legislative history of section 2(c) demonstrates that Congress viewed the ability to offer checking accounts as a critical factor in determining whether an institution is a commercial bank. In practice, NOW accounts are advertised as checking accounts and are used as such. Moreover, NOW accounts are regarded as "transaction accounts" under the Depository Institutions Deregulation and Monetary Control Act of 1980 (Pub. Law No. 96-221; 94 Stat. 132) and, whether offered by commercial banks or thrift institutions such as savings and loan associations, are subject to the reserve requirement ratios that apply to demand deposits. (12 U.S.C. § 461). By subjecting NOW accounts to transaction account reserve requirements, Congress recognized that NOW accounts are checking accounts.[3] In view of the function, substance and attributes of NOW accounts, Congress' treatment of NOW accounts, and the potential for evasion of the act associated with NOW accounts,[4] the Board has determined that offering of NOW accounts must be regarded as falling within the first part of the test of whether an institution is a "bank" under section 2(c) of the act.

Accordingly, a nonbanking subsidiary of a bank holding company may not offer NOW accounts and also engage in

[2] Similarly, in *First National Bank in Plant City* v. *Dickinson*, 396 U.S. 122, 136 (1968), the Supreme Court held that for purposes of branch banking laws, legal rights between private parties are not necessarily decisive in determining whether a deposit has been created when it is clear that the practical effect of a transaction is the receipt of a deposit.

[3] In authorizing NOW accounts, Congress clearly intended to permit the payment of interest on such accounts, notwithstanding the general prohibition on the payment of interest on demand deposits. However, there is no indication that by authorizing the offering of NOW accounts Congress intended to exempt institutions that provide such accounts from the definition of "bank" in the Bank Holding Company Act.

[4] Because NOW accounts generally perform the same functions as demand deposits, an institution seeking to evade the act might attempt to use such accounts as a substitute for demand deposits. See *Wilshire Oil*, supra.

the business of making commercial loans.[5] Such dual activity is not "closely related to banking" but in fact is banking for purposes of the Bank Holding Company Act. Thus, the Board regards any industrial banking institution that both offers NOW accounts and engages in the business of making commercial loans as a "bank" for purposes of the Bank Holding Company Act.[6] An application to acquire such an institution is subject to approval under section 3 of the act rather than section 4. Thus, the subject application under section 4 of the act may be approved only on the condition that Beehive Thrift will not both offer NOW accounts and engage in the business of making commercial loans.[7]

An industrial bank acquired under section 4 of the act may, however, offer NOW accounts (provided that it also does not engage in the business of making commercial loans) because that activity is closely related to banking since banks in fact offer NOW accounts.[8] Before the Board may permit a bank holding company to engage in a closely related activity, however, the Board must also determine that the activity can reasonably be expected to produce public benefits that outweigh possible adverse effects. The Board is concerned that, unless the NOW accounts offered by Beehive

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[5] Although savings and loan associations and savings banks also offer NOW accounts, their lending activities historically have been concentrated in home mortgages and their commercial lending activities are generally quite limited. This and other facts persuade the Board that the activities of such institutions presently authorized by federal statute law generally do not constitute engaging in the business of making commercial loans, and that such institutions are not "banks" for purposes of the act.

[6] Beehive Thrift devotes a substantial portion of its assets to general commercial loans and is engaged in the business of making commercial loans within the meaning of the act.

[7] However, if Beehive Thrift secured FDIC insurance, as is required by section 3(e) of the act, Applicant could acquire Beehive Thrift under section 3 of the act, and Beehive Thrift could both offer NOW accounts and make commercial loans under such circumstances.

[8] The board's previous approvals of bank holding company applications to acquire industrial banking institutions did not authorize the offering of NOW accounts or other types of transaction accounts (such as automatic transfer accounts) by such institutions because those applications did not reference such accounts.

Thrift are subject to interest rate limitations and reserve requirements that apply when such accounts are offered by commercial banks or savings and loan associations, the offering of NOW accounts by an industrial loan company subsidiary of a bank holding company can, and is likely to, undermine the important public policy objectives of the Depository Institutions Deregulation and Monetary Control Act of 1980. In that act, Congress established a policy that all transaction accounts at depository institutions should be subject to interest rate ceilings and reserve requirements.[9]

The Board regards the offering of NOW accounts that are not subject to interest rate ceilings and reserve requirements as an adverse effect within the meaning of § 4(c)(8) of the Bank Holding Company Act, and concludes that it outweighs the public benefits offered by the proposal.[10] Accordingly, the proposal will be approved only if the NOW accounts offered by Applicant are subject to the same federal interest rate limitations and reserve requirements that apply to a federally insured depository institution.

Consummation of the proposal may be expected to result in public benefits in the form of expanded services at Beehive Thrift and, if the proposal is modified as indicated above, would not result in any undue concentration of resources, conflicts of interests, unsound banking practices, or other adverse effects.[11]

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[9] The Board believes that the ownership by bank holding companies of industrial loan institutions that offer NOW accounts could undermine the act's objectives by encouraging the growth of transaction deposits at such institutions and diverting deposits away from institutions that are subject to Regulations D and Q.

[10] The Board expressly reserves judgment as to whether more compelling public benefits might be sufficient to outweigh this adverse effect.

[11] In determining that the offering of NOW accounts is a permissible bank holding company activity subject to the conditions specified herein, the Board has taken into consideration the state regulation applicable to industrial loan companies in Utah. The Board notes that Utah law provides for insurance of NOW accounts up to $10,000, establishes minimum capital and reserve requirements for industrial loan companies, and limits the amount of funds that may be loaned to any one borrower. Moreover, the bank commissioner is authorized to monitor the affairs of industrial

Accordingly, based upon the foregoing and all the facts of record, the Board has determined that the balance of public interest factors that the Board is required to consider under section 4(c)(8) if favorable, provided that Applicant complies with the following limitations: Applicant, through Beehive, may not both offer NOW accounts and engage in the business of making commercial loans. If Applicant does not engage in the business of making commercial loans, but does offer NOW accounts, such accounts will be subject to the same interest rate limitations and reserve requirements that would apply to a federally insured depository institution.

Accordingly, the application is hereby approved as conditioned herein. This determination is also subject to the conditions set forth in § 225.4(c) of Regulation Y and to the Board's authority to require such modification or termination of the activites of a holding company or any of its subsidiaries as the Board finds necessary to assure compliance with the provisions and purposes of the act and the Board's regulations and orders issued thereunder, or to prevent evasion thereof.

The activities shall be commenced not later than three months after the effective date of this Order, unless such period is extended for good cause by the Board or by the Federal Reserve Bank of San Francisco, pursuant to delegated authority.

By order of the Board of Governors, effective March 12, 1982.

Voting for this action: Chairman Volcker and Governors Wallich, Partee, Teeters, and Rice. Absent and not voting: Governor Gramley.

(Signed) JAMES MCAFEE,
Associate Secretary of the Board.

[SEAL]

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loan companies in order to ensure the safety of the deposits accepted by such institutions. The commissioner is also empowered to limit the investments of industrial loan companies, and may issue orders to enforce such determinations.

BOARD OF GOVERNORS
OF THE
FEDERAL RESERVE SYSTEM
WASHINGTON, D.C. 20551

December 10, 1982

Mr. William M. Isaac
Chairman
Federal Deposit Insurance Corporation
550 Seventeenth Street, N.W.
Washington, D.C. 20429

Dear Chairman Isaac:

This is in reference to the Notice of Change in Bank Control filed by the Dreyfus Corporation, New York, New York ("Dreyfus"), with the Federal Deposit Insurance Corporation regarding Dreyfus' proposed acquisition of Lincoln State Bank, East Orange, New Jersey ("Lincoln Bank"), a State nonmember insured bank. A copy of the notice was provided to the Board by the New York Regional Office of the Federal Deposit Insurance Corporation for comment.

In its notice, Dreyfus contends that the Bank Holding Company Act (the "BHC Act") is inapplicable to its proposed acquisition of Lincoln Bank on the ground that Lincoln Bank would not be a "bank" under the BHC Act since the bank will, prior to its acquisition by Dreyfus, divest its commercial loan portfolio and thereafter cease to engage in the business of making commercial loans within the meaning of the BHC Act. Dreyfus asserts that this action is sufficient to convert Lincoln Bank from a bank to a nonbank under the BHC Act.

The BHC Act prohibits a bank holding company from engaging in the type of nonbanking activities in which Dreyfus is engaged, and provides that any company that acquires control of a bank must obtain the prior approval of the Board. Section 2(c) of the BHC Act defines the term "bank" as any institution that both accepts demand deposits and "engages in the business of making commercial loans." 12 U.S.C. § 1841(c). By its express terms, the Change in Bank Control Act is not applicable to a transaction that requires

the Board's prior approval under section 3 of the BHC Act. 12 U.S.C. § 1817(j)(16).

In connection with the Board's review of Dreyfus' notice, the Federal Reserve Bank of New York and the Board's staff requested that Dreyfus provide the Board with a detailed description of Dreyfus' proposed plans with respect to Lincoln Bank, particularly with respect to the bank's future lending activities and the extent of the bank's future relationships with Dreyfus and its affiliates. Dreyfus limited its reply to a statement that it planned to assist Lincoln Bank in marketing the bank's deposits to the customers of mutual funds that Dreyfus manages and that it expects to place the bank's funds in certificates of deposit of other banks and similar market instruments "in accordance with sound banking practice and applicable law."

Dreyfus' proposed acquisition of Lincoln Bank is the latest example of a recent trend by nonbanking organizations to acquire commercial banks and to transform such banks into so-called "nonbank banks" by divesting the bank's commercial loan portfolio in an effort to avoid the prohibitions of the BHC Act. The acquisition of such nonbank banks by nonbanking organizations such as Dreyfus is predicated upon an amendment to the definition of "bank" in the BHC Act in 1970. That amendment added to the demand deposit test in the statute the requirement that the institution also be engaged in the business of making commercial loans.

The legislative history of the BHC Act is clear that this amendment was designed for a very limited and special situation involving a single trust company and that the amendment was to be very narrowly applied by the Board.[1] The statement by the House members of the Conference Committee regarding the 1970 Amendments to the BHC Act states that "the Board should interpret [this] exemption[s] as narrowly as possible in order that all bank holding companies which should be covered under the Act in order to

[1] *One-Bank Holding Company Legislation of 1970: Hearings Before the Senate Committee on Banking and Currency*, 91st Cong., 2d Sess., 136-137 (1970).

protect the public interest will, in fact, be covered." H.R. Rep. No. 91-1747, 91st Cong., 2d Sess. 23 (1970).

Between 1970 and 1981, the exemption remained within the narrow confines intended by Congress. In its 1972 decision regarding the Boston Safe Deposit & Trust Company, the Board held that under the BHC Act a commercial loan is any loan other than a loan the proceeds of which are used to acquire property or services used by the borrower for personal, family, household or charitable purposes. The Board, however, stated that the sale of federal funds or the purchase of market instruments such as certificates of deposit, commercial paper, and bankers acceptances would not cause Boston Safe to be regarded as engaged in the business of making commercial loans under the BHC Act in the limited context of the trust company's fiduciary activities. The Board expressly pointed out that its decision was limited to the specific facts of that case. The narrow Boston Safe decision does not and was never intended to exempt from the BHC Act a commercial bank that engages in commercial funding activities of the kind proposed by Dreyfus for Lincoln Bank.

In its 1981 opinion regarding the acquisition by Gulf and Western of Fidelity National Bank, Concord, California, the Board abstained from applying the BHC Act because of assurances that the bank to be acquired would not engage in commercial lending, would limit its loans to individuals for personal, family, household or charitable purposes, and would not be used in any manner to further or enhance the activities of Gulf and Western or its affiliates. The Board did not, however, define or limit the type of loans that are covered as commercial loans under the definition of bank in the Act. In connection with the acquisition by Chrysler Corporation of Automotive Financial Services Inc., an uninsured institution, the only function of which would be to process Chrylser's drafts, the Board expressly stated that the institution may not make commercial loans, including the purchase of commercial paper or bankers acceptances.

During the past year, the Board has noted the large number of acquisitions of "nonbank banks" by nonbanking organizations apparently in reliance on the 1970 amendment to the

definition of bank in the BHC Act and has considered the potential for evasion of the purposes of the BHC Act that are present in the combination of such banking and nonbanking organizations. In particular, the Board is concerned with the difficulty of assuring the enforcement of the prohibition on commercial lending and interrelated activities where the close links associated with common control would be established between the demand deposit-taking function of the "nonbank bank" and commercial lending activities conducted through separate corporate subsidiaries of the parent organization. Moreover, the proliferation of such acquisitions would allow for the expansion of banking across state lines without either state authorization or Congressional approval.

Accordingly, the Board has concluded that the acquisition of nonbank banks has become a vehicle for a substantial evasion and undermining of the BHC Act and that action is necessary to confine the so-called "nonbank bank" exception to the scope originally intended by Congress. To this end, the Board has examined the nature and function of various types of extensions of credit for the purpose of specifying the nature and extent of lending activities that qualify an institution as "engaged in the business of making commercial loans" under the BHC Act. As noted, the Board has consistently held that a commercial loan under the BHC Act is any loan other than a loan the proceeds of which are used to acquire property or services used by the borrower for personal, family, household or charitable purposes. This definition of commercial loan is broad in scope and includes the purchase of such instruments as commercial paper, bankers acceptances, and certificates of deposit, the extension of broker call loans, the sale of federal funds, the deposit of interest bearing funds and similar lending vehicles.[2] These transactions, both in law and in substance, establish a debtor-creditor relationship between business enterprises for purposes that are not personal, family, household, or charitable.

[2] The sale of federal funds and interest bearing deposits were long regarded by the Board as extensions of credit under section 23A of the Federal Reserve Act prior to enactment of the Garn-St Germain Depository Institutions Act of 1982. 96 Stat. 1469.

It is undisputed that Lincoln Bank will continue to accept demand and other transaction deposits and use its deposits to purchase market instruments such as certificates of deposit of other banks.[3] Applying the Board's interpretation of the BHC Act outlined above, it is clear that such activity by an institution that accepts demand deposits and that is chartered and holds itself out as a commercial bank constitutes engaging in the business of making commercial loans within the meaning of the BHC Act and that such an institution is a "bank" under the BHC Act. Thus, the acquisition of control of such a bank by a nonbanking organization such as Dreyfus effects an impermissible commingling of banking and commerce and is prohibited by the BHC Act. In light of the information received regarding Dreyfus' plans for the operations and lending activities of Lincoln Bank, the Board has concluded that Lincoln Bank, after its acquisition by Dreyfus, would continue to accept demand deposits and to be engaged in the business of making commercial loans and that Dreyfus' proposed acquisition of Lincoln Bank is subject to the Board's prior approval under the BHC Act.

Finally, the Board notes that the divestiture plan proposed by Dreyfus for Lincoln Bank's existing commercial loan portfolio, under which the portfolio would be transferred to the Bank of New York, as trustee, until the portfolio could be sold to other banks, is not sufficient to cause Lincoln Bank to cease to be engaged in the business of making commercial loans or to terminate Lincoln Bank's status as a bank under the BHC Act.

For the foregoing reasons, the Board has concluded that Lincoln Bank, a chartered and insured commercial bank, is a bank under the BHC Act and that Dreyfus may not lawfully acquire shares of Lincoln Bank without obtaining the Board's prior approval under section 3(a)(1) of the BHC Act. Accordingly, the Board requests that the FDIC advise Dreyfus that Dreyfus' notice with respect to its proposed acquisition of Lincoln Bank is, as a matter of law, improperly filed under the Change in Bank Control Act because of the

[3] Dreyfus advised the Board that Lincoln Bank will cease making broker call loans and selling federal funds to other financial institutions.

Board's formal determination that the proposed bank acquisiton is subject to section 3 of the Bank Holding Company Act (12 U.S.C. § 1842) and that Dreyfus may not consummate its proposed acquisition in reliance on the Change in Bank Control Act.

While the Board has taken the action described in this letter to limit the 1970 amendment to the definition of bank within the narrow scope intended by Congress, it is clear that it would be desirable for Congress to review the general question of the scope of the definition of bank for the purposes of the BHC Act. Accordingly, the Board intends to request Congress to address this issue at its next session and will submit suggestions for legislative action.

Very truly yours,

/s/ William W. Wiles
WILLIAM W. WILES
Secretary of the Board

cc: Joseph Diamond

COMPTROLLER DECISION TO CHARTER DREYFUS NATIONAL BANK & TRUST COMPANY

This decision relates to the application to charter Dreyfus National Bank & Trust Company which will be located at 600 Madison Avenue, New York, New York.

The Application

The application requests the issuance of a charter to establish the Dreyfus National Bank & Trust Company ("Dreyfus Bank"). Dreyfus Bank initially will concentrate on offering trustee services, custodial services, investment management, and plan administration support to small and midsize employee benefit plans and personal retirement plans. However, it is expected that in the future, Dreyfus Bank will also offer certain deposit certificates and serve as trustee for collective investment funds for pension and profit sharing as well as other institutional investors. As described more fully, *infra*, Dreyfus Bank will not engage in the business of making commercial loans nor will it offer demand deposit accounts.

The Organizers

All of the organizers of Dreyfus Bank are associated with the Dreyfus Corporation ("Dreyfus Corp."), and the new national bank will be a wholly-owned subsidiary of Dreyfus Corp.

Dreyfus Corp. was originally formed as the investment adviser to the Nesbett Fund under the name of John G. Nesbett & Co., Inc. In 1951, a partnership under the name of Dreyfus & Co. acquired the Nesbett Fund and changed its name to The Dreyfus Fund. At that time, Nesbett's investment adviser became subsidary of Dreyfus & Co. and changed its name to Dreyfus Corp. In 1965, Dreyfus & Co. sold to the public 95% of its interest in Dreyfus Corp.

In 1969, The Dreyfus Service Corporation ("Distributor") was organized as a wholly-owned subsidiary of Dreyfus Corp. to serve as underwriter for the distribution of mutual fund shares. Distributor registered as a broker/dealer and became a member of the Philadelphia and Pacific Stock Exchanges.

In 1970, Dreyfus Management, Inc. ("Management") was organized as a subsidiary of Dreyfus Corp. Management serves as investment adviser to various pension funds and other individual accounts. It does not act as investment adviser to any mutual funds.

In addition to the Dreyfus Fund, Dreyfus Corp. also acts as investment adviser to, among others, the Dreyfus Leverage Fund, Dreyfus Number Nine, Dreyfus Third Century, Dreyfus Liquid Assets, Dreyfus Tax Exempt Bond fund, Dreyfus Tax Exempt Money Market Fund, Dreyfus Government Securities Series of Dreyfus Money Market Instruments, and Dreyfus Money Market Fund. These funds, along with other Dreyfus Corp. advised funds, comprise the Dreyfus group of mutual funds.

Dreyfus Corp. also serves as administrator and/or subinvestment adviser of several other money market funds sponsored jointly with independent financial institutions. Dreyfus Corp. currently manages or administers assets of approximately $23.3 billion held by various mutual funds and other investment accounts.

Dreyfus Corp. has also recently acquired Lincoln State Bank, East Orange, New Jersey, subsequent to that bank's divestiture of its commercial loan portfolio.

According to the application, Dreyfus Bank will not have any common officers, directors, or employees with Dreyfus Corp., Distributor, Management, or any of the Dreyfus-advised funds.

The issuance of a bank charter to Dreyfus Bank raises certain issues under the Bank Holding Company Act and the Glass-Steagall Act. The first part of this decison deals with the Bank Holding Company Act issues. The latter part address Glass-Steagall concerns.

I. Bank Holding Company Act Issues

A financial institution qualifies as a "bank" for purposes of the Bank Holding Company Act ("BHCA") if it both "(1) accepts deposits that the depositor has a legal right to withdraw on demand, *and* (2) engages in the business of making commercial loans...." 12 U.S.C. §1841(c)(emphasis added). In its application, Dreyfus Bank has indicated that it will meet neither part of this two-part test. Regarding demand

deposits, the application states that "it is not presently contemplated that the Bank will offer checking account services." Additionally, the application indicates that, at least in the early phases of its operation, Dreyfus Bank will not accept deposits of *any* type. Regarding commercial lending, the application states that Dreyfus Bank will not "engage in the business of making commercial loans."

Although Dreyfus Bank's original application contained the above quoted representations, the Board of Governors of the Federal Reserve System ("Board"), in a December 14, 1982 letter to the Comptroller of the Currency, stated that "the Board considers that [Dreyfus Bank] would be a bank within the meaning of the Bank Holding Company Act...." In making this statement, the Board specifically relied on the reasoning set out in a letter of December 10, 1982, which it sent to the Federal Deposit Insurance Corporation ("FDIC"). That letter concerned the acquisition by Dreyfus Corp. of Lincoln State Bank following that bank's divestiture of its commercial loan portfolio. The December 10 letter stated that, as interpreted by the Board, the BHCA term "commercial loan" included not only traditional commercial loans, but also a wide range of money market activities. The activities specifically mentioned in this regard were "the purchase of such instruments as commercial paper, bankers acceptances and certificates of deposit, the extension of broker call loans, the sale of federal funds, the deposit of interest bearing funds and similar lending vehicles."[1]

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[1] The FDIC, in a letter of December 29, 1982, to the Board, responded to the Board's letter of December 10. It stated that:

> [T]he Federal Reserve Board has dramatically recast the definition of commercial loan by including within it certain activities that clearly had been excluded from the definition in the past. While we acknowledge the Board's authority to interpret the Bank Holding Company Act, we believe such a radical departure from the traditional view of what constitutes a commercial loan raises issues beyond the scope of regulatory interpretation.

Based on this analysis of the Board's December 10 letter, the FDIC issued a letter to Dreyfus Corp. conveying its intent not to disapprove of the acquisition of Lincoln State Bank. In explaining this action, which was contrary to the course recommended by the Board in its December 10 letter, the FDIC's December 29 letter stated that "the FDIC was constrained to follow the clear legal precedents established over the years...."

The Board's assertion that Dreyfus Bank will be a "bank" under the BHCA is apparently based on the assumption that Dreyfus Bank will both accept demand deposits and engage in one or more of the activities described in the Board's December 10, 1982 letter to the FDIC. By letter of January 14, 1983, Dreyfus Corp. confirmed that, as indicated in its application, Dreyfus Bank does not intend to offer demand deposit accounts. Dreyfus Corp. also indicated that:

> Should [Dreyfus]Bank, in the future, offer time deposits, it is Dreyfus' intention that the Bank would invest the funds derived therefrom (apart from possible investments in personal, family, household or charitable loans) in one or more of the following: certificates of deposit, interest-bearing deposit accounts with other banks, bankers' acceptances, the sale of "federal funds" and government obligations....

Based on the application and Dreyfus Corp.'s January 14, 1983 letter, the Comptroller has concluded that Dreyfus Bank will not be a "bank" for purposes of the BHCA. This conclusion is inescapable in light of the fact that Dreyfus Bank will not accept "deposits that the depositor has a legal right to withdraw on demand"—an activity necessary for qualification as a bank under the BHCA. Therefore, Dreyfus Corp. need not obtain the Board's advance approval in connection with this application.

Because the absence of demand deposit activity is determinative of the question of whether Dreyfus Bank will be a bank under the BHCA, the Comptroller need not determine whether Dreyfus Bank would satisfy the commercial lending test of section 1841(c) through the sale of Federal funds, the making of bank deposits or the purchase of certificates of deposit or bankers' acceptances. However, the Board's December 10 letter commenting on the effect under the BHCA of engaging in these and other money market activities was directed to and considered by the Comptroller in connection with the Dreyfus Bank application. The Comptroller therefore believes it appropriate in deciding the Dreyfus Bank application to offer the following comments regarding the Board's position as expressed in that letter.

A. Past Board Interpretations

The Board's December 10 letter appears to constitute an abrupt and profound departure from the Board's past interpretations of the BHCA term "commercial loan." In determining whether a financial institution will be a "bank" for purposes of the BHCA, those interpretations appear to focus on whether the institution in question has no commercial loan portfolio and has taken steps to ensure that its demand deposit-taking functions will remain separate from the commercial lending activities of its affiliate. *See, e.g.*, the Board's (unpublished) March 11, 1981 letter to Robert C. Zimmer regarding the acquisition by the Gulf and Western Corporation of Fidelity National Bank, Concord, California.

The Board's past interpretations have not indicated that the BHCA term "commercial loan" includes a broad range of money market activities. In fact, the Board has made publicly available a number of interpretations which indicate that the term "commercial loans" does not include certain of the very money market activities which the Board found in its December 10 letter to be included in that term.

For example, an (unpublished) May 18, 1972 letter from the Board to Lee J. Aubrey, Vice President of the Federal Reserve Bank of Boston, stated that Boston Safe Deposit and Trust Company ("Boston Safe") was not making commercial loans for purposes of the BHCA when it sold federal funds and purchased certificates of deposit, commercial paper, and bank acceptances. An (unpublished) January 26, 1976 letter to Michael A. Greenspan from Baldwin B. Tuttle, the Board's Deputy General Counsel, stated that a trust company operating under the Board's Regulation Y[2] would not be engaged in the business of making commercial loans for purposes of the BHCA when it made broker call loans. The letter also noted that, under Regulation Y, nonbank trust companies may engage in the "purchase of money market instruments such as certificates of deposit, commercial paper ... and banker's acceptances."[3] and that these activi-

[2] 12 C.F.R. §225.

[3] 12 C.F.R. §225.4(a)(4)(iii).

ties will not bring the subject financial institutions within the BHCA definition of "bank." In a May 28, 1981 letter to Chrysler Corporation (Fed. Banking L. Rep. (CCH) ¶ 98,770), the Board stated that a state-chartered bank to be owned by a Chrysler Corporation subsidiary would not be a "bank" for purposes of the BHCA by virtue of "the purchase of United States government and agency obligations, certificates of deposit and time deposits, and repurchase agreements of financial institutions with respect thereto ...." Notably, this letter states that, in contrast, Chrysler's nonbank bank should not invest in commercial paper and bankers' acceptances since those instruments "could substitute for commercial loans." However, even this cautioning statement regarding two specific money market investments does not appear to be fully consistent with the Board's December 10 letter to the FDIC. The statement that the two investments could *substitute for* commercial loans appears to indicate that (contrary to the December 10 letter) the two investments are not definitionally include in the BHCA term "commercial loan."

B. The Purpose and Legislative History of the BHCA

The BHCA contains no definition of the term "commercial loan." Nor has the Federal Reserve Board issued regulations defining the term. Because the scope of the term is unclear, its meaning must be determined by reference to the purpose and legislative history of the BHCA. The Comptroller believes that the inclusion of money market transactions within the BHCA term "commercial loans" is not supported by the purpose or the legislative history of the BHCA. Therefore, we are unable to agree with the statement in the Board's December 10 letter that "the acquisition of nonbank banks has become a vehicle for a substantial evasion and undermining of the BHC Act...."

The purpose of the BHCA is "to restrain undue concentration of commercial banking resources and to prevent possible abuses related to the control of commercial credit."[4] The primary commercial banking abuses to be prevented are unsafe

[4] S. Rep. No. 1084, 91st Cong., 2d Sess. (1970) *reprinted in* 1970 U.S. Code Cong. & Admin. News 5519, 5541.

loans to nonbank affiliates, credit allocation practices favoring nonbank affiliates and tying arrangements.[5] In 1970, Congress narrowed the BHCA definition of "bank" in order to exclude financial institutions which accept demand deposits but do not "engage in the business of making commercial loans." In doing so, Congress explained that this change was consistent with the BHCA purpose of preventing the above-described commercial banking abuses. The Senate report stated that:

> [T]he Federal Reserve Board has noted that [the BHCA definition of "bank"] may be too broad and may include institutions which are not in fact engaged in the business of commercial banking in that they do not make commercial loans.[6]

As the Board noted in its December 10 letter, the narrowing of the definition of "bank" was prompted by the case of one trust company, *i.e.*, Boston Safe.[7] As the Board's letter also noted, the exemption created by the narrowing of the definition of "bank" (like a number of other exemptions created by the 1970 legislation) should be interpreted by the Board "as narrowly as possible in order that all bank holding companies which should be covered under the [BHCA] in order to protect the public interest will, in fact, be covered."[8] However, it is clear that the narrowing of the definition of "bank" was not intended to be applicable only to Boston Safe. It is also clear that Congress did not intend the exemption created by that narrowing to be so restrictively interpreted as to subject to the BHCA those financial institutions which need not be subject to the BHCA in order to effect that Act's purpose.

The Comptroller believes that the Board's December 10 definition of commercial loans is not supported by either the general purpose of the BHCA or the specific purpose of the 1970 narrowing of the definition of "bank." As noted, the

[5] *See, e.g.*, 115 Cong. Rec. 32903 (1969) (remarks of Rep. Moorhead).

[6] S. Rep. No. 1084, 91st Cong. 2d Sess. (1970) *reprinted in* 1970 U.S. Code Cong. & Admin. News 5519, 5541.

[7] *See* 116 Cong. Rec. 25848 (1970).

[8] H.R. Rep. No. 91-1747, 91st Cong. 2d Sess. 23 (1970).

specific purpose underlying the narrowing of the definition of "bank" was to exempt entities like Boston Safe which accepted demand deposits but did not engage in the business of making commercial loans. However, as evidenced by the previously noted May 18, 1972, Board letter to Mr. Aubrey, Boston Safe engaged in a number of the various money market activities that the Board's December 10 letter finds to be the making of commercial loans, *i.e.*, the sale of Federal funds and the purchase of certificates of deposit, commercial paper and bankers' acceptances.[9] Thus, if the Board's December 10 interpretation of the commercial loan test is correct, the 1970 amendment would not, of itself, have been sufficient to effect the purpose for which it was intended. The fundamental rules of statutory construction would appear to cast serious doubt on an interpretation of the BHCA which would produce such a result.[10]

The general purposes of the BHCA also appear to provide no support for the Board's December 10 interpretation of commercial loans. These general purposes are discussed in a previously noted January 26, 1976, letter from the Board's Deputy General Counsel to Mr. Greenspan regarding broker call loans. That letter stated that:

> [N]onbank trust companies owned by bank holding companies are permitted to make call loans to securities dealers under section 225.4(a)(4)(iii) of Regulation Y because this type of loan is distinguishable from the ordinary commercial loan in that such call loans are entered into on a daily renewable basis with both parties having the option not to renew, are made primarily as a means of temporarily investing idle funds, and are viewed by the lending institution as an alternative to the purchase of money market instruments, such as commercial paper or bankers' acceptances. This type of "call loan" is thus viewed as a passive medium of investment, with the lender making a daily investment judgment based on its analysis of money market rates. "Call loans" thus do not appear to have the close lender-borrower relationship that is one of the characteristics of commercial loans and which presents the possibility of abuses relating to the control of commercial credit that concerned the Congress in adopting the commercial lending test. Thus to the extent that [the inquiring financial institution] engages in brokers' call loans of this character, the Legal Division believes that such activities would not cause it to be engaged in the business of making commercial loans. [Footnotes omitted.]

[9] *See also* Moody's Investor Service, Inc., 1972 Moody's Bank and Finance Manual 663-664 (December 31, 1970, Financial Statement of Boston Safe Deposit and Trust Company.

[10] *See* C. Sands, Sutherland Statutory Construction §45.5 (4th ed. 1973).

For essentially the same reasons cited above, the Comptroller believes that there are serious questions as to whether any of the money market activities mentioned in the Board's December 10 letter are commercial loans for purposes of the BHCA. All those money market activities involve only very short term funding commitments by the banks involved. They are an essentially passive medium of investment, are reviewed on a very frequent basis, and do not involve a close lender-borrower relationship. For these reasons, the subject money market activities have little potential of involving the types of commercial lending abuses which Congress wished to prevent through the BHCA.

Although the legislative history and purpose of the BHCA do not appear to support the Board's December 10 interpretation of the applicability of the BHCA to any of the above-discussed money market activities, this lack of support appears to be even more evident in the case of interbank transfers of funds. As noted previously, the chief commercial lending abuses sought to be prevented by the BHCA are imprudent loans to nonbank affiliates, unfair credit allocation favoring nonbank affiliates, and anticompetiti[illegible]ying arrangements. These potential abuses are, at most, extremely remote when a bank is engaged in money market activities with other banks, rather than with its nonbank affiliates.

II. Glass-Steagall Act Issues

Because Dreyfus Corp. and its subsidiaries are involved in certain securities activities, the issuance of a national bank charter raises issues under the Glass-Steagall Act. The only applicable portion of the Glass-Steagall Act is section 20, 12

U.S.C. §377. Sections 16, 21, and 32 of the Act are clearly inapplicable.

Section 16 of the Glass-Steagall Act, 12 U.S.C. §24 (Seventh), only restricts certain securities activities of a national bank itself. It contains no restrictions on the securities activities of a national bank's affiliates. The restrictions of section 21 of the Act, 12 U.S.C. §378, have been interpreted similarly by the Supreme Court as applying only to the activities of the bank:

> [T]he language of §21 cannot be read to include within its prohibition separate organizations related by ownership with a bank, which does receive deposits.

Board of Governors v. Investment Company Institute, 450 U.S. 46 58 n. 24 (1981). Thus, sections 16 and 21 are not applicable to the establishment of Dreyfus Bank since the bank itself will not engage in any prohibited securities activities.

Section 32 of the Act, 12 U.S.C. §78, prohibits an individual primarily engaged in certain securities activities from serving as an officer, director, or employee of a member bank. As explained earlier, Dreyfus Bank will have no common officers, directors, or employees with Dreyfus Corp., Distributor, Management, or any of the Dreyfus-advised funds. Accordingly, there is no potential section 32 violation involved.[11]

A. Section 20

The remaining section of Glass-Steagall, section 20, provides that:

> [N]o member bank shall be affiliated in any manner described in subsection (b) of section 221a of this title with any corporation, association, business trust, or other similar organization *engaged principally* in the issue, flotation, underwriting, public sale, or distribution at wholesale or retail or through syndicate participation of stocks, bonds, debentures, notes or other securities. . . .

[11] This is in accord with the Board's December 14, 1982 letter to the Comptroller of the Currency concerning the Dreyfus Bank application. In that letter, the Board concluded that a section 32 violation would occur only "if Dreyfus intends to establish any management interlocks between Dreyfus National and Dreyfus or any of the Dreyfus-managed mutual funds . . . ." Board Letter at p.2.

12 U.S.C. §377 (emphasis added). Dreyfus Bank will be an affiliate of Dreyfus Corp., Distributor, and Management.

The financial data for Dreyfus Corp., its two subsidiaries, and the Dreyfus organization on a consolidated basis for the first nine months of 1982 are set forth below.[12]

	Total Gross Revenues	Total Sec. 20 Revenues	Sec. 32 Revenues as % of Total Gross Revenue
Dreyfus Corp.	$75,957,000	-0-	0%
Distributor	539,000	310,000	58%
Management	3,820,000	367,000	0%
Consolidated	$80,316,000	$310,000	0.004%

Dreyfus Corp. itself is engaged in no section 20 activities. Thus, its proposed affiliation with Dreyfus Bank poses no section 20 problem. Management also is engaged in no section 20 activities. Accordingly, the proposed affiliation between Management and Dreyfus Bank also poses no section 20 problem.

While revenues from Distributor's section 20 activities constitute less than one-half of one percent of the consolidated revenues of Dreyfus Corp. and its subsidiaries, they constitute 58% of the total revenues of Distributor. Thus, if Distributor were considered alone, it would be an impermissible affiliate of Dreyfus Bank because it is "engaged principally" in section 20 activities.

To determine whether an entity is "engaged principally" in section 20 activities, it is appropriate to refer to the Supreme Court's decision in *Board of Governors v. Agnew*, 329 U.S. 441 (1947).

That decision was an interpretation of the "primarily engaged" language of section 32. However, in the course of its opinion the Court analyzed the interrelationship of "en-

[12] The dollar amounts and percentages of section 20 revenues for Dreyfus Corp., Distributor, and Management are substantially similar for the year ended 1981. For the sake of simplicity, the section 20 analysis need only employ the most recent figures.

gaged" (section 21), "primarily engaged" (section 32) and "engaged principally" (section 20) as those terms are used in Glass-Steagall, making clear that the degree of business necessary to be "engaged principally" in an activity is greater than the degree of business necessary to be "primarily engaged" in an activity. 329 U.S. at 446-448.

A firm that receives less than 10% of its gross income from section 32 business is clearly not "primarily engaged" in such business.[13] Under the "single entity" theory, as explained below, Distributor must be considered as part of the total Dreyfus enterprise for section 20 purposes. The resulting consolidated entity derives less than one-half of one percent of total revenues—$310,000 for the first nine months of 1982—from section 20 activities. Since these consolidated figures do not approach the level required to satisfy the "primarily engaged" test of section 32, they obviously cannot violate the less stringent section 20 test of "engaged principally."

B. "Single Entity" Theory

The "single entity" theory disregards, under appropriate circumstances, the separate corporate existence of a subsidiary engaged in section 20 activities in determining whether a corporate group affiliated with a member bank is, as a whole, "principally engaged" in section 20 activities. The Comptroller has previously found the theory to be a valid analytical technique. Where a subsidiary is wholly-owned and acts as a servicing or selling arm in connection with the activities of the parent, the theory is particularly pertinent. To hold otherwise would needlessly require corporations wishing to avoid section 20 violations to dissolve separate subsidiaries engaged in section 20 activities and to assume

[13] Decision of the Comptroller of the Currency on the Application to Charter J. & W. Seligman Trust Co., N.A., February 1, 1983, at p. 9, n. 5. Previous Board opinions have also suggested that a firm receiving more than $10 million in gross income from section 32 business is "primarily engaged" in such business. This figure has not been adjusted for inflation and was not mentioned in the Board staff's December 14, 1981 opinion. Staff Opinion 3-939, *Federal Reserve Regulatory Service*, Vol. 1, pp. 389-390.

those responsibilities directly, even though there are many legitimate business reasons explaining and justifying separate incorporation.[14]

The Supreme Court has indicated that the single entity theory is an appropriate technique for analyzing affiliations and management interlocks in the context of the relevant Glass-Steagall Act provisions. As pointed out in the Comptroller's decision to charter J. & W. Seligman Trust Company, N.A.,[15] the Court endorsed this approach in a section 32 context in *Investment Company Institute v. Camp*, 401 U.S. 617, 626 & n.12 (1971). Moreover, by rejecting the theory as a means of interpreting the absolute prohibitions in section 16 and 21, the Court in a 1981 decision implicitly endorsed its use for the "less stringent standard" in section 20.[16] As our earlier decision also noted, the Board has repeatedly used the theory to analyze section 32 violations and, in at least one instance, to determine the absence of a section 20 violation.

The Comptroller finds the single entity theory to be applicable here because Distributor performs only activities which could be performed by Dreyfus Corp. itself (and would, if so performed, obviate any section 20 problems because of the small amount of section 30 activities vis-a-vis other activities), and because Distributor's activities are performed solely on behalf of Dreyfus Corp. in connection with its sponsorship of a family of investment companies which it advises. Furthermore, the principal reason for Distributor's incorporation as a separate subsidiary was to take advantage of lower net capital requirements under the Securities Exchange Act of 1934. This is a legitimate business reason for using the subsidiary approach and as such should not have

[14] Among the legitimate business reasons is a desire to minimize liability, ease the impact of regulation and taxation, and provide a large number of executive positions in an organization. The latter consideration can be a useful marketing tool, since some potential customers may prefer to deal with the "president" or a subsidiary rather than with an "assistant vice president" of a corporation without subsidiaries.

[15] *See* note 13, *supra*.

[16] *Board of Governors v. Investment Company Institute*, 450 U.S. 46, 58-59 n.24 and n.26 (1981).

any effect on the Glass-Steagall analysis. Accordingly, the proposed charter would not violate section 20.

C. The Dreyfus-Advised Funds

The Comptroller has determined that Dreyfus Bank would not be "affiliated," as that term is defined in 12 U.S.C. §221a(b), with any of the Dreyfus group of mutual funds,[17] and therefore would not be in violation of section 20 of Glass-Steagall. Subsections (1), (3), and (4) of section 221a(b) are clearly inapplicable here, Dreyfus Bank will not own a majority of the voting shares of any advised fund. None of the directors of any advised fund will be directors of Dreyfus Bank. An advised fund will not own or control, directly or indirectly, a majority of the shares of Dreyfus Bank, or more than 50% of the number of shares voted for election of the directors of Dreyfus Bank, or control in any manner the election of a majority of the directors of Dreyfus Bank. Therefore, the sole question is whether, under the meaning of subsection (2), the parent of Dreyfus Bank (*i.e.*, Dreyfus Corp.) controls "through stock ownership or in any other manner" the advised funds. Since the percentage ownership by Dreyfus Corp. and its subsidiaries of any of the shares of the advised funds is minimal,[18] the question becomes whether Dreyfus Corp. "controls" those funds "in any other manner."

The specific types of affiliations identified in Section 221a(b) all relate to control of companies at the level of equity ownership or board selection or control. They do not cover control of day-to-day management in situations where that is not coupled with the sort of policy control exerted by a board of directors or a shareholder acting through the

[17] This determination is important since an open-ended fund is apparently regarded by the Board as "engaged principally in the issue" of securities. Board letter, *supra* n. 11, at p. 2.

[18] At September 30, 1982, Dreyfus Corp. had investments of $51,012,000 in the shares of four advised mutual funds. In no instance did the percentage investment in any fund exceed 1%. These funds represented working capital of Dreyfus Corp. placed on a temporary basis, and as such may fluctuate daily. Additionally, at September 30, 1982, Dreyfus Corp. had invested a total of $540,000 as initial paid-in capital for purposes of initiating sixteen new mutual funds at such date. These investments represented the required "seed money" for purposes of organizing such mutual funds.

elected board. In our view, the more general reference to "control . . . in any other manner" in § 221a(b)(2) is intended to cover only control that relates to the same sort of policy level control covered by the numerous specific types of control specified in § 221a(b) and not the managerial authority vested in corporate officers or contractual managers such as investment advisers.

Such an interpretation is in accord with the *ejusdem generis* doctrine of statutory construction. Under this rule, where specific words of definition (*e.g.*, control through majority share ownership or election of directors) are used in a statute along with general words of definition (*e.g.*, control in any other manner), the general words must be construed to encompass only situations similar in nature to those enumerated in the specific words.[19] If the general definitional words were to be given their most expansive meaning, they would obviously include those situations designated by the more specific definitional words, making the specific words superfluous. Accordingly, the phrase "control . . . in any other manner", as used in section 221(b), should only include types of control similar in nature and effect to majority shareholding or the election of directors, *i.e.*, the ability to control policy.

The issue arises as to whether a mutual fund's investment adviser "controls" that fund for Glass-Steagall purposes. The Comptroller, who has ample authority to interpret the Glass-Steagall Act,[20] has determined that the Investment Company Act of 1940 ("the Act") confers so much authority on

[19] *See* C. Sands, Sutherland Statutory Construction § 47.17 (4th ed. 1973).

[20] *See, e.g.*, OCC opinions on bank proposals to offer discount brokerage services, CCH Fed. Banking L. Rep. ¶ 99,284; to issue mortgage-backed pass-through securities, CCH [1973-1978 Transfer Binder] Fed. Banking L. Rep. ¶ 97,093; to offer bank automatic investment services, CCH [1973-1978 Transfer Binder] Fed. Banking L. Rep. ¶ 96,272, upheld on the merits in *New York Stock Exchange* v. *Smith*, 404 F. Supp. 1091 (D.D.C. 1975), *vacated on ripeness grounds*, 562 F.2d 736 (D.C. Cir.), *cert. denied*, 435 U.S. 942 (1978). Numerous staff opinions, published and unpublished, have been issued over the years; *see, e.g.*, "OCC Staff Analysis of Certain Legal Issues Raised by Retail Repurchase Agreements" at 5 (accompanying Banking Circular 157 dated May 13, 1981), 5 CCH Fed. Banking L. Rep ¶ 60,798.35 at 38,857.

the disinterested members of a fund's board that control, as the term is used in section 221a(b), of a fund by its investment adviser appears to be precluded, especially where, as here, each fund's board is comprised of a majority of disinterested directors. The Comptroller reached a similar conclusion in the February 1, 1983 decision approving the charter of J. & W. Seligman Trust Company, N.A.[21] Because that recent decision contains an in-depth discussion of the Act and its protective features,[22] the analysis need not be repeated here. It should be sufficient to note that the Comptroller's conclusion in the J. &W. Seligman decision was that the operations of mutual funds are directed by the fund's directors, not by the fund's advisers or managers. At least 40% of the directors of a fund must be disinterested persons, to whom the Act assigns especially sensitive tasks, including what the Supreme Court describes as the "critical functions" of approving the advisory contracts and selecting the accountants.[23] In short, even in a situation where only 40% of a fund's directors are disinterested persons, the Act can be regarded as a statutorily mandated system for independent directorial governance of investment companies, a system which negates control by the adviser.[24] The specific issue of the role of the independent directors of a Dreyfus-advised mutual fund (Dreyfus Liquid Assets) has been considered in a recent court decision. In *Krasner v. Dreyfus Corp.*, 90 F.R.D. 665 (S.D.N.Y. 1981), a case involving the reasonableness of the investment advisory fee charged by the investment adviser (*i.e.*, Dreyfus Corp.), the court noted that:

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[21] *See* note 13, *supra*.

[22] Decision of the Comptroller, *supra* n. 13, at 16-22.

[23] *Burks v. Lasker*, 441 U.S. 471, 485 n. 15 (1979). It should be noted that the Act also gives the directors special termination rights over the advisory contract. Specifically, the contract must provide "that it may be terminated at any time, without the payment of any penalty, by the board of directors . . . on not more than sixty day's written notice to the investment adviser." 15 U.S.C. §80a-15(a)(3). Moreover, the Act's legislative history makes clear that Congress intended the directors to have a fiduciary duty with respect to "all of the affairs of the fund." S. Rep. No. 184, 91st Cong., 1st Sess. at 6 (1969).

[24] Decision of the Comptroller, *supra* n. 13, at 21-22.

> Section 15(c) of the Act further requires the directors of a fund to request and evaluate the same type of information that the Adviser is obligated to provide. The Court is satisfied that the directors, all of whom are reputable people in business and the professions, have done just that. In addition, under section 15(c), a management agreement can only be approved by a majority of non-interested directors appearing in person at a special meeting called for that purpose. As noted previously, this requirement was met in this case.
>
> The board meetings held to approve the management agreement were conducted in the following manner. Each meeting was attended by both the Fund's independent counsel, who advised the non-interested directors of their fiduciary obligations, and personnel from Dreyfus, who provided information and answered questions. When the non-interested directors were satisfied that they had received sufficient information, the Dreyfus personnel left the meeting, and the non-interested directors continued their discussions in private, with their attorney present. At each such meeting, the management agreement was approved unanimously by the non-interested directors. In short, the deliberations of the directors were a matter of substance rather than a mere formality.

Id. at 671, 672.

According to correspondence received from Dreyfus Corp., a majority of the Directors of *each* Dreyfus-advised mutual fund are disinterested directors as that term is defined in the Act. At each Board of Director's meeting, the directors, a majority of whom are disinterested, review in detail the fund's investment portfolio. In addition, the directors review the financial operations as well as legal, operational and other significant matters. The directors conduct these reviews with representatives of the investment adviser who respond in detail to questions posed by the directors and independent counsel who represent the fund and its independent counsel who represent the fund and its independent directors. The directors are further provided with detailed information so that they can review the services rendered by the investment adviser during the preceding year.

The Board appears to have recently taken the view that an organization which sponsors, organizes or manages a fund also "controls" it for purposes of section 20.[25] It has also recently suggested that correct use of the single entity theory in this context requires the inclusion in the consolidated Dreyfus enterprise of the investment companies or funds for which Dreyfus Corp. serves as investment adviser.[26] Normally, the Comptroller would give great deference to the Board's views. However, for the reasons stated above, we are unable to do so here. Moreover, the Board's views represent a departure from past Board precedents and do not appear to be legally supportable.[27] In fact, the Supreme Court, in *Board of Governors v. Investment Company Institute*, 450 U.S. 46, 50-51 (1981), specifically recognized that investment advisers of investment companies typically manage the Company's business. Nevertheless, the Court upheld a ruling of the Board that bank affiliates could serve as investment advisers at least if they did not "organize, sponsor, or control" the investment companies.

In addition to the lack of any management control, there is also a lack of any control through share ownership. In no instance does aggregate share ownership of any fund by all Dreyfus Corp. officers and directors as a group exceed 1% of outstanding shares. With respect to ownership of Dreyfus Corp., there are no individuals who can be viewed as controlling stockholders. Share ownership is widely dispersed and traded on the New York Stock Exchange. The largest single stockholding that of the Chairman of the Board, President, and Chief-Executive Officer of Dreyfus Corp., amounts to less than 6% of Dreyfus Corp.'s outstanding shares.

Accordingly, both as a matter of law and of fact, Dreyfus Corp. does not "control" the funds it advises within the meaning of 12 U.S.C. §221a(b)(2). The provisions of the In-

[25] Board Letter, *supra* n. 11, at p. 2.

[26] Board Letter, *supra*, n. 11, at p. 3.

[27] *See* 12 C.F.R. §225.125(f) ("In the Board's opinion, the Glass-Steagall Act provisions . . . forbid a bank holding company to sponsor, organize or *control* a mutual fund.") (emphasis added.)

vestment Company Act, the particular characteristics of Dreyfus Corp. and of the advised funds, and the absence of any controlling shareholders establishes the lack of any section 221a(b) affiliation between Dreyfus Corp. and those funds. Accordingly, the issuance of a charter for a national bank, the stock of which is to be owned by Dreyfus Corp. will not cause a violation of section 20.

Conclusion

Establishment of Dreyfus Bank will not violate either the Bank Holding Company Act or the Glass-Steagall Act. Furthermore, the Office has determined that the application complies with the provisions of 12 C.F.R. Parts 5 and 9 relating to the organization of a national bank with trust powers.[28] Accordingly, preliminary approval to organize a National Bank with trust powers is hereby granted.

Dated 2/4/83

C.T. Conover
Comptroller of the Currency

[28] Of course, Dreyfus Bank will be subject to all statutory and regulatory provisions applicable to national banks. For example, under 12 U.S.C. §374a, a member bank may not act as agent for any nonbanking entity in making loans to brokers or dealers with securities as collateral. Moreover, the Comptroller has taken the position under 12 C.F.R. Part 9 that it is a breach of trust for a trustee to purchase assets for its fiduciary accounts from or through itself or an affiliate without having specific authority therefor in the appropriate governing instrument, or from an authorized person. Pursuant to this interpretation, the Office has stated that a bank trustee could place transactions through an affiliate only if that affiliate executes those actions at cost and does not make a profit in the process.

FEDERAL DEPOSIT INSURANCE CORPORATION,
Washington, D.C. 20429
Deputy to the Chairman

December 29, 1982

Mr. William W. Wiles
Secretary of the Board of Governors
of the Federal Reserve System
20th & Constitution Avenue, N.W.
Washington, D.C. 20551

Dear Mr. Wiles:

We are writing in response to your letter of December 10, 1982, commenting on the proposed acquisition of Lincoln State Bank by The Dreyfus Corporation ("Dreyfus"). As you know, the Board of Directors of the FDIC has issued a letter to Dreyfus conveying its intent not to disapprove the acquistion of control. It was the conclusion of the FDIC Board that Dreyfus' notice of change of control was properly submitted to the FDIC under the Change in Bank Control Act of 1978, and our Board of Directors was required to respond within the time constraints of the statute.

We have reviewed analogous acquisitions of "nonbank banks" and note that a number of clear precedents exist, dating back a number of years, for a bank to be held exempt from the definition of "bank" in the Bank Holding Company Act based on the divestiture of its commercial loan portfolio prior to the acquisition and its agreement not to engage in the business of making commercial loans in the future. By failing to object previously to that now fairly routine practice, the Federal Reserve Board has, in our judgment, acquiesced in, if not expressly agreed with, a more limited definition of commercial loan on which the public has come to rely.

Heretofore, the Federal Reserve Board's analysis of what constitutes a commercial loan has focused on direct lending activities and has not suggested that the entire spectrum of money market activities and interbank transfers of funds should be incorporated into the concept. In fact, the Federal Reserve Board has published opinions interpreting the definition of "commercial loans" specifically to exclude certain activities such as issuance of certificates of deposit (Boston

Safe, 1972); broker call loans (Bradford Computer Systems, Inc., 1976); and purchase of United States government and agency obligations, certificates of deposit and time deposits, and repurchase agreements of financial institutions (Chrysler Corporation/Automotive Financial Services, Inc., 1981). We do not ignore that the Federal Reserve Board sought to limit those interpretations to their particular sets of facts; nevertheless, the Board's consistent use of a more limited definition of commercial loan led to the warranted assumption that the term included certain activities and excluded others. Now, in its analysis of the Dreyfus acquisition, the Federal Reserve Board has dramatically re-cast the definition of commercial loan by including within it certain activities that clearly had been excluded from the definition in the past. While we acknowledge the Board's authority to interpret the Bank Holding Company Act, we believe such a radical departure from the traditional view of what constitutes a commercial loan raises issues beyond the scope of regulatory interpretation.

The FDIC is in general agreement with the Federal Reserve Board about the desirability of maintaining the traditional lines of distinction between banking and commerce; however, Dreyfus is a financial services company and not a corporation engaged in general commerce. Moreover, we believe it would be inappropriate for the FDIC or the Federal Reserve Board to undertake to resolve these kinds of public policy issues. We firmly believe that Congress is the appropriate authority to reassess the statutory distinctions among banking institutions, thrifts, securities firms, other providers of financial services and commercial firms in general, and to resolve the underlying question of the activities in which banks and bank holding companies shall be permitted to engage.

The FDIC would join the Federal Reserve Board in requesting the Congress to undertake a comprehensive review of this issue. However, we could not support stop-gap or stand-alone legislation to merely redefine the term "bank" or "commercial loan." The far-reaching developments in the marketplace that have occurred over the past decade do not lend themselves to a simple solution along these lines. We

cannot ignore, for example, such mixing of federally-insured savings and loan associations with commercial enterprises as Sears and National Steel, particularly in view of the new commercial lending authority for thrifts contained in the Garn-St Germain Act. Nor can we ignore the securities firms, such as Shearson and Fidelity, that own commercial banks, as well as operate money market funds and engage in a full range of financial services. Numerous other examples exist of marketplace developments that have "outgrown" existing law. The point is, they call not for regulatory reinterpretation, but for legislative action.

In sum, while our Board was attentive to the concerns expressed in your letter of December 10, 1982, it concluded that the FDIC was constrained to follow the clear legal precedents established over the years and that any change in policy should be brought about by Congressional, not agency, action. We intend to support next year a broad-based Congressional review of the activities in which banks, thrifts, and their holding companies or affiliates should be permitted to engage.

Sincerely,

/S/ Margaret L. Egginton
MARGARET L. EGGINTON
Deputy to the Chairman

cc: Joseph Diamond

Mr. Lee J. Aubrey
Vice President
Federal Reserve Bank of Boston
Boston, Massachusetts 02106

May 18, 1972

Dear Mr. Aubrey:

The Board has considered certain questions under the Bank Holding Company Act involving Boston Safe Deposit and Trust Company. Please advise that company of the following:

It is the Board's understanding that Boston Safe Deposit and Trust Company ("Boston Safe"), a wholly-owned subsidiary of The Boston Company, Inc., is principally engaged in a trust business. Boston Safe also accepts demand deposits and makes a limited number of loans to individuals; the loans are secured by nonbusiness assets, are made as a courtesy to trust customers, and are made only on an occasional and irregular basis. However, proceeds of some such loans have been used for business purposes by the borrowers. The total amount of such loans that are for business purposes is understood to be approximately 1½ per cent of the total assets of Boston Safe. Furthermore, it is understood that Boston Safe does not solicit any loan business.

The question raised by these facts are whether loans made to individuals for business purposes and fully secured by nonbusiness assets are encompassed within the meaning of the term "commercial loans" for purposes of section 2(c) of the Bank Holding Company Act ("Act") and, if so, whether Boston Safe "engages in the business of making" such loans as the phrase is used in section 2(c) of the Act.

Section 2(c) defines "bank" as an organization which accepts demand deposits and engages in the business of making commercial loans. The Board has defined the term "commercial loans" for purposes of section 2(c) as including all loans to an individual, secured or unsecured, other than a loan the proceeds of which are used to acquire property or services used by the borrower for his own personal, family, or household purposes, or for charitable purposes. Loans to individuals for business purposes secured by nonbusiness assets fall within that definition. The Board has reconsidered

its definition to determine whether such loans should be included. Based upon the purposes of the Act and the mandate from Congress to construe all exemptions narrowly, including the exception derived from the section 2(c) definition of "bank", the Board has concluded that such loans fell within the phrase "commercial loans".

The Board has also considered whether Boston Safe "engages in the business of making" such loans and has concluded that Boston Safe does not so engage since such loans are made only occasionally, and Boston Safe makes such loans only as an accommodation to its trust customers and neither solicits such loan business nor operates a credit department.

The Board understands that Boston Safe purchases "money market instruments", such as certificates of deposit, commercial paper, and bank acceptances. In the circumstances of this case, such transactions are not regarded as commercial loans for the purposes of the Act.

On the basis of the facts presented, the Board has concluded that Boston Safe will not be regarded as engaged "in the business of making commercial loans" for purposes of the Holding Company Act by virtue of its loans to individuals, so long as Boston Safe does not make any commercial loans other than on the basis indicated above, its loan transactions are also on a limited and occasional basis for the accommodation of trust customers only, and in any event, are not in an amount in excess of 2 per cent of assets.

A further aspect of Boston Safe's operations is its engagement in Federal funds transactions which, according to Boston Safe's 1971 Report of Condition, amounted to $8 million of Federal funds sold outstanding as of December 31, 1971. The Board has previously taken the position, and continues to adhere to the position, that the sale of Federal funds constitutes an unsecured loan. The Board has concluded however that the sale of Federal funds by Boston Safe is not tantamount to the making of a commercial loan, for purposes of the Act.

Of course, Boston Safe should be advised that all the Board's conclusions in these matters are subject to revoca-

tion or amendment if any of the facts upon which those conclusions are based change in any material respect.

Very truly yours,

(signed) Michael A. Greenspan
MICHAEL A. GREENSPAN
Assistant Secretary

Date: February 10, 1981

Office Correspondence

Subject: Purchase of the Guaranteed Portions of Small Business Administration and Farmers Home Administration Loans.

ISSUE PRESENTED: Whether the proposed purchase by ______ of the United States guaranteed portions of Small Business Administration ("SBA") and Farmers Home Administration ("FmHA") loans would constitute engaging "in the business of making commercial loans" within the meaning of section 2(c) of the Bank Holding Company Act of 1956, as amended ("Act"), bringing ______ within the definition of "bank" contained in section 2(c) of the Act.

CONCLUSION: ______ proposed purchase of the guaranteed portions of SBA's and FmHA's would not constitute engaging "in the business of making commercial loans" within the meaning of section 2(c) of the Act.

BACKGROUND: By letter dated November 13, 1980 (Attachment A), the Board's Legal Division responded to the Federal Reserve Bank ______ request for an opinion on whether the proposed purchase by ______ (a trust company) of the guaranteed portions of SBA's and FmHA's would constitute engaging "in the business of making commercial loans" within the meaning of section 2(c) of the Act. According to the information received by the Board, ______ proposes to purchase guaranteed portions of SBA's and FmHA's only from nonbank dealers on the secondary market. Pursuant to federal regulations governing these lending programs, there is a strict separation of borrower, lender, and purchaser. Purchasers may not hold any interest in the underlying borrower, note, or in the collateral for the loan, other than the interest represented by the SBA or FmHA itself. In the event of a borrower's default on a loan, purchasers must look solely to the federal government for recovery. SBA's and FmHA's are general obligations of the United States secured by its full faith and credit. ______, will not originate such loans, nor will it purchase or acquire the unguaranteed portions of such loans.

DISCUSSION: The definition of "bank" contained in section 2(c) of the Act was amended in 1970. The original definition,

adopted by Congress in 1966, "... was designed to include commercial banks and to exclude those institutions not engaged in commercial banking, since the purpose of the act was to restrain undue concentration of commercial banking resources and to prevent possible abuses related to the control of commercial credit." However, the Board "... noted that this definition may be too broad and may include institutions which are not in fact engaged in the business of commercial banks in that they do not make commercial loans."[1] Therefore, Congress added a second test, "engages in the business of making commercial loans," to its original definition of bank as "any institution ... which accepts deposits that the depositor has a legal right to withdraw on demand." Congress cautioned that any exemption from its definition should be made "as narrowly as possible in order that all bank holding companies which should be covered under the Act in order to protect the public interest will, in fact, be covered."[2]

In determining what constitutes "commercial lending", the Board has looked to the purposes for which a loan was made, finding that lending for personal, family or household purposes is not commercial lending. (*Greater Providence Deposit Corp.*, letter dated July 1, 1971; *Boston Safe Deposit and Trust Company*, letter dated June 8, 1972). The Board also has concluded that, although commercial in nature, the purchase of federal funds, money market instruments (certificates of deposit, commercial paper, and bankers acceptances) are not considered commercial loans *for the purposes of section 2(c) of the Act*, despite the fact that for other statutory and regulatory purposes these instruments may be considered commercial loans. (*Boston Safe*) Likewise, Board staff determined that broker call loans and sold securities transactions are not considered commercial loans *for the purposes of section 2(c) of the Act.* (*Bradford Trust Company*, letter dated January 26, 1976.) These determinations were based upon the specific characteristics of these instruments and transactions involving them. In each instance, the Board

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[1] S. Rep. No. 91-1084, 91st Cong., 2nd Sess. (1970), p. 24.

[2] H.R. Rep. No. 91-1747, 91st Cong., 2nd Sess. (1970), p. 23.

or its staff found that these transactions did not involve the particular type of lender-borrower relationship that is one of the characteristics of commercial loans, and which presents the possibility of abuses relating to control of commercial credit that concerned Congress when it adopted the commercial lending test. These decisions subsequently were incorporated into the description of permissible activities for a section 4(c)(8) trust company contained in section 225.4(a)(4)(iii) of the Board's Regulation Y, 12 C.F.R. § 225.4(a)(4)(iii).

Finally, the Board found that loans made by a trust company to individuals for commercial purposes on an occasional basis as a courtesy to its trust customers would not be regarded as "engaging in the business of making commercial loans" for purposes of section 2(c) of the Act as long as the trust company *"does not make any commercial loans other than on the basis indicated above, its commercial bank transactions are on a limited and occasional basis for the accommodation of trust customers only, and in any event, are not in an amount in excess of 2 percent of assets." (Boston Safe.)*[3]

January 26, 1976

Michael A. Greenspan, Esq.
Metzger, Noble, Schwartz & Kemplar
One Farragut Square South
Washington, D.C. 20006

Dear Mr. Greenspan:

This is in response to your request for the Legal Division's opinion on the status of your client Bradford Computer Systems, Inc. ("Bradford") under the Bank Holding Company Act of 1956, as amended ("Act") in light of certain proposed activities of Bradford and/or its subsidiary Bradford Trust Company ("Company").

Under section 3(a)(1) of the Act (12 U.S.C. 1842(a)(1)) it is unlawful, except with prior Board approval, for any action to be taken that causes any company to become a bank holding company. Since a bank holding company is defined to mean any company that has "control" over a "bank", as those terms are defined in the Act, Bradford would have to file an application to become a bank holding company if Company proposed to engage in activities that would make it a "bank" within the meaning of section 2(c) of the Act or if Bradford proposed to acquire control of another institution that would be defined as a "bank" under the Act. The term "bank" is defined in section 2(c) of the Act (12 U.S.C. 1841(c)) to mean "... any institution organized under the laws of the United States, any State of the United States ... which (1) accepts deposits that the depositor has a legal right to withdraw on demand, and (2) engages in the business of making commercial loans...."

It is stated in your correspondence that you have advised Bradford that if Company conducts only those activities permissible for a nonbanking trust company subsidiary of a bank holding company under section 4(c)(8) of the Act and § 225.4(a)(4) of Regulation Y, then Bradford does not have to apply to become a bank holding company. You base this opinion on the fact that under section 4(c)(8) of the Act and Regulation Y, bank holding companies can acquire voting share interests in trust companies located outside of their State of principal banking operations. Since section 3(d) of

the Act prohibits the Board from approving any bank holding company acquisition of any voting shares of, interest in, or all or substantially all of the assets of an additional "bank" located outside of a bank holding company's State of principal banking operations, as determined in that section, it is your opinion that if a trust company limits its activities to those prescribed under section 4(c)(8) of the Act and section 2245.4(a)(4) of Regulation Y, the Board has determined that it is thus not a "bank" within the meaning of the Act. You request that the Legal Division concur in this opinion and concur also with your opinion that Company may make "broker call loans" because such loans are not commercial loans, based in part upon your opinion that nonbanking trust company subsidiaries of bank holding companies may make such loans under section 225.4(a)(4) of Regulation Y. You also request the Legal Division's concurrence with your opinion that if Company engages in certain so-called "sold securities transactions", as hereinafter described, these specific activities would not cause Company to be engaged in the business of making commercial loans within the meaning of section 2(c). In this regard, you base your opinion on your view that these sold security transactions either should be regarded as broker call loans or should not in any event be regarded as a form of commercial loan within the meaning of section 2(c) of the Act.

The Legal Division generally concurs with your opinion that if a trust company confines its activities to those specified under section 225.4(a)(4) of the Regulation Y, then it does not come within the definition of "bank" in section 2(c) of the Act. With respect to the permissible "broker call loan" activities of a trust company under the regulation, section 225.4(a)(4)(iii) of Regulation Y provides that a trust company in which a bank holding company has an interest may engage in the "making of call loans to securities dealers or purchase of money market instruments such as certificates of deposit, commercial paper, government or municipal securities, and bankers' acceptances". In the Legal Division's judgment, the making of brokers' call loans by trust company subsidiaries of bank holding companies is permissible under the foregoing regulation, based on its understand-

ing that such call loans constitute merely a method of investing a trust company's idle funds and do not constitute a type of revolving credit business loan.[1] Essentially, in the Legal Division's opinion, nonbank trust companies owned by bank holding companies are permitted to make call loans to securities dealers under section 225.4(a)(4)(iii) of Regulation Y because this type of loan is distinguishable from the ordinary commercial loan in that such call loans are entered into on a daily renewable basis with both parties having the option not to renew, are made primarily as a means of temporarily investing idle funds, and are viewed by the lending institution as an alternative to the purchase of money market instruments, such as commercial paper or bankers' acceptances. This type of "call loan" is thus viewed as a passive medium of investment, with the lender making a daily investment judgment based on its analysis of money market rates. "Call loans" thus do not appear to have the close lender-borrower relationship that is one of the characteristics of commercial loans and which presents the possibility of abuses relating to the control of commercial credit that concerned the Congress in adopting the commercial lending test.[2] Thus to the extent that Company engages in brokers' call loans of this character, the Legal Division believes that such activities would not cause it to be engaged in the business of making commercial loans.

With respect to "sold security transactions", it is understood from your description that these transactions would be conducted as follows: A selling broker, for a fee, delivers securities he has sold to Company, with instructions attached that contain the name and address of the out-of-town buyer, the amount to be paid, and the name of the bank or other institution that will take payment. Also attached to the securities is a negotiable draft for collection, which incorporates the foregoing information and which is entered as a receivable on the trust company's books. The securities are for-

[1] See the Board's Order of December 23, 1975 approving The Toronto-Dominion Bank's retention of the Toronto Dominion Bank Trust Company, New York, New York under § 4(c)(8) of the Act and § 225.4(a)(4) of Regulation Y.

[2] See S. Rep. No. 91-1084, 91st Cong., 2d Sess., p. 248.

warded to the named bank for delivery and the draft is presented to said bank for collection. The entire process normally takes two days. As is customery for other trust companies, it is proposed that Company, at the broker's request, give the broker immediate credit on the draft.

In the Legal Division's opinion, this type of transaction does not appear to involve a broker call loan within the meaning of section 225.4(a)(4)(iii) of Regulation Y, as it is not a means for temporarily investing idle funds of the trust company. Rather, this transaction essentially involves giving a broker immediate credit in his account for a draft drawn on another trust company or bank, such draft being drawn in payment for securities sold by the broker. You state that it is your view that, as in the case of immediate credit given on a check, the Company will look primarily for repayment to the bank on which the draft is drawn, and not to the broker. Based on the foregoing, the Legal Division believes that should Company engage in "sold security transactions" with its broker customers, as described herein, this activity, in and of itself, would not appear to cause Company to be engaged in the business of making commercial loans within the meaning of section 2(c).

Apart from your requests pertaining to "broker call loans", I note also that you have indicated that Bradford proposes to organize a so-called limited purpose national bank under a charter issued by the Comptroller of the Currency to engage in trust company activities. In this regard, you have requested staff concurrence of your view that the charter powers of a company do not determine whether it is a "bank" within the meaning of section 2(c) of the Act, but rather it is the specific activities of the company that is determining. You base your opinion on a Board letter of June 7, 1972 to Mr. Lawrence Stone, General Counsel of the Federal Reserve Bank of Boston, regarding the status of Boston Safe Deposit and Trust Company under section 2(c) of the Act. You state that you are interested in obtaining the staff's views because the Office of the Comptroller of the Currency believes that such an institution owned by Bradford would be in the public interest but is uncertain whether the charter or by-laws should be restricted in order

to keep the institution from being a "bank" under the Act or whether the institution should simply not exercise the full powers given. From an administrative and regulatory standpoint, the Legal Division believes that the former course of action i.e., actually limiting the charter powers of the organization, would be the preferable course of action and would best fulfill the purposes of the Act and the Board's regulations. The Legal Division chooses at this time not to express any views on your opinion that the charter powers of a company do not determine whether it is a "bank", as it feels there are policy aspects to such a general position that should be considered by the Board.

Pursuant to your requests, the views expressed herein are, of course, solely those of the Board's Legal Division and, as such, do not constitute an interpretation by the Board of the provisions of the Act or Regulation Y or a Board decision or ruling on the facts presented.

Very truly yours,

(signed) Baldwin B. Tuttle
BALDWIN B. TUTTLE
Deputy General Counsel

ADDENDUM H

November 13, 1980

Mr. William N. McDonough
Assistant General Counsel
Federal Reserve Bank of Boston
Boston, Massachusetts 02106

Dear Bill:

This is in response to your letters of June 26, and July 7, 1980, in which you request the opinion of the Board's Legal Division as the whether the proposed purchase by ______ ("Company") of the guaranteed portions of Small Business Administration and Farmers Home Administration loans would constitute engaging "in the business of making commercial loans" within the meaning of section 2(c) of the Bank Holding Company Act of 1956, as amended ("Act"), bringing Company within the definition of "bank" contained in section 2(c) of the Act.

According to the information you have forwarded to the Board, Company proposes to purchase those portions of loans made by the Small Business Administration and the Farmers Home Administration that are fully guaranteed by the United States, pursuant to programs administered by the two agencies. These guaranteed portions, commonly known as "SBA's" and "FmHA's", are sold by nonbank dealers on the secondary market. Pursuant to federal regulations governing these lending progress, there is a strict separation of borrower, lender, and purchaser. Purchasers may not hold any interest in the underlying borrower, note, or in the collateral for the loan, other than the interest represented by the SBA or FmHA itself. In the event of a borrower's default on a loan, purchasers must look solely to the federal government for recovery. Company has represented that all of its purchases of SBA's and FmHA's will be made from nonbank dealers in the secondary market. Company will not originate such loans, nor will it purchase or acquire the unguaranteed portions of such loans.

The Legal Division concurs in your view that Company's purchase of SBA's and FmHA's, in the manner outlined above, would not constitute engaging "in the business of making commercial loans" within the meaning of section 2(c) of the Act. Rather, the purchase of SBA's and FmHA's by Company as described appears to be a passive medium of investment, representing an alternative to the investment of Company's idle funds in government securities, inasmuch as SBA's and FmHA's are similar to government securities in that they are general obligations of the United States secured by its full faith and credit. Moreover, SBA's and FmHA's do not appear to involve the particular type of lender-borrower relationship that is one of the characteristics of commercial loans, and which presents the possibility of abuses relating to the control of commercial credit that concerned Congress when it adopted the commercial lending test, found in the Act. (See S. Rep. No. 91-1084, 91st Cong., 2nd Sess., p. 248.)

Therfore, the Legal Division concludes that the proposed purchase by Company of SBA's and FmHA's would not bring Company within the definition of "bank" contained in section 2(c) of the Act. If you have any further questions concerning this matter, please contact Ms. Bronwen Mason (202/452-3564) or Ms. Sara Kelsey (202/452-3236) of the Board's Legal Division.

Very truly yours,

(signed) Robert E. Mannion
ROBERT E. MANNION
Deputy General Counsel

EDITOR'S NOTE

THE FOLLOWING PAGES WERE POOR HARD COPY AT THE TIME OF FILMING. IF AND WHEN A BETTER COPY CAN BE OBTAINED, A NEW FICHE WILL BE ISSUED.

ADDENDUM I

ENTER SELECTION # OR DONE--> 1

VALLEY NATIONAL BANK		BANK ADMINISTRATION INSTITUTE	CA1285
SALINAS CA		INDIVDUAL BANK PROFILE -- 1982	RES. CLASS 5
AVERAGE ASSETS		INCOME/EXPENSE	
1 CASH & DUE FROM BANKS	19,473	32 INTEREST & FEES ON LOANS	7,277
2 INTEREST-BEARING BALANCES	0	33 INT ON BALANCES WITH BKS	1,137
		34 INT ON FED FUNDS SOLD	911
3 U.S.TREASURY SECURITIES	149	35 INT ON U.S. SECURITIES	265
4 SEC - OTHER U S AGENCIES	2,795	37 INT ON OBLIG OF STATES	896
5 OBLIGATIONS OF STATES	13,159	38 INT ON OTHER SECURITIES	22
6 OTHER SECURITIES	0	39 INC FRM DIRECT LEASE FIN	366
TOTAL INVSTMT SECURITIES	16,103	TOTAL INTEREST INCOME	10,874
7 FED FUNDS SOLD	5,304		
		40 INT ON TIME DEP OVR 100M	490
8 REAL ESTATE LOANS--RES ID	7,578	41 INT ON OTHER TIME & SVGS	5,110
9 REAL ESTATE LOANS--OTHER	9,551	42 INT ON FOREIGN DEPOSITS	0
10 INSTALLMENT LOANS	28,908	43 INT ON FED FUNDS PURCHAS	0
11 COMMERCIAL AND INDUSTRIAL	0	44 INT ON OTHR BORRWD MONEY	82
12 AGRICULTURAL LOANS	0	45 INT ON CAPITAL NOTES	0
13 OTHER LOANS	11,456	TOTAL INTEREST EXPENSE	5,682

ENTER MORE OR DONE--> MORE

TOTAL LOANS GROSS	57,493		
14 LESS: UNEARNED DISCOUNT	5,875	NET INTEREST MARGIN	5,192
TOTAL LOANS	51,618		
15 LESS: ALLOW/LOAN LOSS	373	46 TRUST DEPARTMENT INCOME	0
TOTAL LOANS NET	51,243	47 OTHER OPERATING INCOME	1,613
16 DIRECT LEASE FIN	2,250	TOT OTHR OPER INC	1,613
17 PROPERTY	2,910		
18 OTHER ASSETS	2,857	48 SALARIES AND BENEFITS	3,541
		49 BANK PREMIS & FURNITURE	1,309
TOTAL AVERAGE ASSETS	100,140	50 LOAN LOSS PROVISION	56[illegible]
		51 OTHER EXPENSE	3,705
AVERAGE LIABILITIES		OTHER OPERATING EXPENSE	9,215
19 DEMAND DEPOSITS -- IPC	27,014	INC BEF TAX & SEC TRANS	-2,41[illegible]
20 PUBLIC FUNDS--DEMAND	132		
21 OTHER DEMAND DEPOSITS	1,220	52 APPLICABLE INCOME TAXES	[illegible]
TOTAL DEMAND DEPOSITS	28,367	53 INCOME BEFORE SEC GAINS	-2,41[illegible]
22 TIME & SAVINGS--IPC	63,687	54 SEC GAINS AND LOSSES	-[illegible]
23 PUBLIC FUNDS--TIME	0	55 EXTRAORDINARY ITEMS	[illegible]
24 TIME DEPOSITS OVER 100M	3,635		
25 OTHER TIME & SAVINGS	0	NET INCOME	-2,413

ENTER MORE OR DONE--> MORE

TOTAL DOM TIME & SAV	63,686		
TOTAL DOM DEPOSITS	92,053	MISCELLANEOUS	
26 FOREIGN DEPOSITS	0		
TOTAL DEPOSITS	92,053	56 CASH DIV--COMMON STOCK	
		57 REC CREDT-BAD DEBT ALLOW	15[illegible]
27 FED FUNDS PURCHASED	0	58 LOSSES CHRGD TO BAD DEBT	65[illegible]
28 MORTGAGE INDEBTEDNESS	531	59 INC BEF SEC GAIN--1981	[illegible]
29 OTHER LIABILITIES	1,251	60 NET INCOME--1981	56[illegible]
TOTAL LIABILITIES	93,835	61 AVERAGE ASSETS--1981	97,22[illegible]
30 CAPITAL NOTES & DEBENTS	0		
31 EQUITY CAPITAL--TOTAL	6,304		
TOT AVG LIAB, CAP, RES	100,140		

1014 DD

PERFORMANCE (% OF ASSETS)

1	INTEREST INCOME (FTE)	11.61%
2	INTEREST EXPENSE	5.67%

ENTER MORE OR DONE--> MORE

3	NET INTEREST MARGIN	5.94%
4	TRUST INCOME	0.00%
5	SERVICE CHRG ON DEP*	1.13%
6	OTHER NON-INT INCOME	0.47%
7	SALARIES AND BENEFITS	3.53%
8	OCCUP. FURN. EQUIP EXP	1.30%
9	LOAN LOSS PROVISION	0.65%
10	OTHER NON-INT EXPENSE	3.69%
11	LESS FTE ADJUSTMENT	0.76%
12	TAX PROVISION	0.00%
13	RETURN ON ASSETS--OP INC	-2.40%
14	RETURN ON ASSETS--NET INC	-2.40%
15	RETURN ON EQUITY--NET INC	-38.27%

YIELDS AND RATES

16	TAX EQU YIELD-EARN ASSETS	15.45%
17	BREAK EVEN YIELD	17.64%
18	YIELD ON INVEST SEC (FTE)	11.93%
19	YIELD ON LOANS	14.09%
20	NET CHRG-OFFS % AV LOANS	0.96%

ENTER MORE OR DONE--> MORE

21	LOAN LOSS PROV % AV LOANS	1.27%
22	RATE ON TIME & SAVINGS	8.79%
23	RATE ON TOTAL INT FUNDS	8.84%
24	INT EXPENSE % EARN ASSETS	7.54%

CAPITAL POSITION

25	EFFECTIVE TAX RATE-OP INC	0.00%
26	CASH DIV % OPER INC	0.00%
27	CAPITAL FORMATION RATIO	-38.27%
28	EQUITY CAPITAL % ASSETS	6.29%

PRODUCTIVITY

29	EARNING ASSETS % ASSETS	75.16%
30	NON-INT CASH&DUE % ASSETS	19.44%
31	NON-INT INC % NON-INT EXP	18.85%
32	PERSONNEL EXP/EMPLOYEE	$19.037
33	EMPLOYEES PER MILL ASSETS	1.85
34	NON-INT INC % SALARIES	45.55%

USE OF FUNDS
(% EARNING ASSETS)

35	INVESTMENT SECURITIES	21.39%
36	FED FUNDS SOLD	7.04%
37	TOTAL LOANS	73.16%
38	RESERVE FOR LOAN LOSS	0.45%
39	REAL ESTATE LOANS-RESID	8.33%
40	REAL ESTATE LOANS-OTHER	11.76%
41	COMM & INDUSTRIAL LOANS	0.00%
42	PERSONAL LOANS	35.62%
43	AGR/LEASE FIN/OTHER LOAN	16.89%

SOURCE OF FUNDS
(% EARNING ASSETS)

44	DEMAND DEPOSITS IPC*	37.50%
45	PUB FUNDS DEMAND DEPS	0.17%
46	TOTAL DEMAND DEPOSITS*	37.69%
47	SAVINGS DEPOSITS* IPC	43.36%
48	TIME DEPOSITS IPC*	41.24%
49	PUB TIME & SAVG DEPS	0.00%
50	TOTAL TIME & SAVG DEPS	84.60%
51	MEMO: MONEY MARKET CDS	26.61%
52	MEMO: TIME DEPS OVR 100M	4.82%
53	FOREIGN DEPOSITS	0.00%
54	TOTAL DEPS (FGN & DOM)	122.29%
55	BORROWINGS	0.70%
56	NET LARGE LIABILITIES	0.00%
57	NON-RATE ASSET/LIAB GAP	14.69%

GROWTH STATISTICS

58	INCOME BEF SEC TRAN 1-YR	N/A
59	NET INCOME 1-YR	N/A
60	AVERAGE ASSETS 1-YR	10.03%
61	INCME BEF SEC TRANS 5-YR	N/A
62	NET INCOME 5-YR	N/A
63	AVERAGE ASSETS 5-YR	15.33%

* DOMESTIC ONLY

ENTER ST/FDIC NO. ST/CITY/INITIAL. OR DONE —> MI/DETROIT/A
NO MATCH FOUND
ENTER ST/FDIC NO. ST/CITY/INITIAL OR DONE --> CA/CONCORD/F
NO MATCH FOUND
ENTER ST/FDIC NO. ST/CITY/INITIAL OR DONE —> CA/CARLSBAD/W
NO MATCH FOUND

1014 EE

ENTER SELECTION # OR DONE--> 1

ASSOCIATES NATIONAL BANK		BANK ADMINISTRATION INSTITUTE	CA0223
CONCORD CA		INDIVDUAL BANK PROFILE -- 1982	RES. CLASS 3
AVERAGE ASSETS		INCOME/EXPENSE	
1 CASH & DUE FROM BANKS	3,201	32 INTEREST & FEES ON LOANS	4,000
2 INTERST-BEARING BALANCES	0	33 INT ON BALANCES WITH BKS	703
		34 INT ON FED FUNDS SOLD	563
3 U.S.TREASURY SECURITIES	12	35 INT ON U.S. SECURITIES	38
4 SEC - OTHER U S AGENCIES	264	37 INT ON OBLIG OF STATES	0
5 OBLIGATIONS OF STATES	0	38 INT ON OTHER SECURITIES	24
6 OTHER SECURITIES	0	39 INC FRM DIRECT LEASE FIN	137
TOTAL INVSTMT SECURITIES	276	TOTAL INTEREST INCOME	5,465
7 FED FUNDS SOLD	3,090		
		40 INT ON TIME DEP OVR 100M	1,217
8 REAL ESTATE LOANS--RESID	70	41 INT ON OTHER TIME & SVGS	493
9 REAL ESTATE LOANS--OTHER	0	42 INT ON FOREIGN DEPOSITS	0
10 INSTALLMENT LOANS	1,652	43 INT ON FED FUNDS PURCHAS	1
11 COMMERCIAL AND INDUSTRIAL	0	44 INT ON OTHR BORRWD MONEY	2
12 AGRICULTURAL LOANS	0	45 INT ON CAPITAL NOTES	0
13 OTHER LOANS	25,463	TOTAL INTEREST EXPENSE	1,713
ENTER MORE OR DONE--> MORE			
TOTAL LOANS GROSS	27,215		
14 LESS: UNEARNED DISCOUNT	0	NET INTEREST MARGIN	3,752
TOTAL LOANS	27,215		
15 LESS: ALLOW/LOAN LOSS	1,122	46 TRUST DEPARTMENT INCOME	0
TOTAL LOANS NET	26,091	47 OTHER OPERATING INCOME	748
16 DIRECT LEASE FIN	780	TOT OTHR OPER INC	748
17 PROPERTY	770		
18 OTHER ASSETS	2,795	48 SALARIES AND BENEFITS	588
		49 BANK PREMIS & FURNITURE	192
TOTAL AVERAGE ASSETS	37,003	50 LOAN LOSS PROVISION	1,582
		51 OTHER EXPENSE	2,069
AVERAGE LIABILITIES		OTHER OPERATING EXPENSE	4,431
19 DEMAND DEPOSITS -- IPC	1,162	INC BEF TAX & SEC TRANS	69
20 PUBLIC FUNDS--DEMAND	18		
21 OTHER DEMAND DEPOSITS	825	52 APPLICABLE INCOME TAXES	-26
TOTAL DEMAND DEPOSITS	2,008	53 INCOME BEFORE SEC GAINS	95
22 TIME & SAVINGS--IPC	16,111	54 SEC GAINS AND LOSSES	0
23 PUBLIC FUNDS--TIME	49	55 EXTRAORDINARY ITEMS	0
24 TIME DEPOSITS OVER 100M	10,895		
25 OTHER TIME & SAVINGS	0	NET INCOME	95
ENTER MORE OR DONE--> MORE			
TOTAL DOM TIME & SAV	16,159		
TOTAL DOM DEPOSITS	18,167	MISCELLANEOUS	
26 FOREIGN DEPOSITS	0		
TOTAL DEPOSITS	18,167	56 CASH DIV--COMMON STOCK	0
		57 REC CREDT-BAD DEBT ALLOW	7
27 FED FUNDS PURCHASED	0	58 LOSSES CHRGD TO BAD DEBT	187
28 MORTGAGE INDEBTEDNESS	0	59 INC BEF SEC GAIN--1981	396
29 OTHER LIABILITIES	1,998	60 NET INCOME--1981	396
TOTAL LIABILITIES	20,165	61 AVERAGE ASSETS--1981	18,645
30 CAPITAL NOTES & DEBENTS	0		
31 EQUITY CAPITAL--TOTAL	16,838		
TOT AVG LIAB, CAP, RES	37,003		

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PERFORMANCE (% OF ASSETS)

1	INTEREST INCOME (FTE)	14.76%
2	INTEREST EXPENSE	4.62%

ENTER MORE OR DONE--> MORE

3	NET INTEREST MARGIN	10.13%
4	TRUST INCOME	0.00%
5	SERVICE CHRG ON DEP♦	0.18%
6	OTHER NON-INT INCOME	1.83%
7	SALARIES AND BENEFITS	1.58%
8	OCCUP. FURN. EQUIP EXP	0.51%
9	LOAN LOSS PROVISION	4.27%
10	OTHER NON-INT EXPENSE	5.59%
11	LESS FTE ADJUSTMENT	0.00%
12	TAX PROVISION	-0.07%
13	RETURN ON ASSETS--OP INC	0.25%
14	RETURN ON ASSETS--NET INC	0.25%
15	RETURN ON EQUITY--NET INC	0.56%

YIELDS AND RATES

16	TAX EQU YIELD-EARN ASSETS	17.42%
17	BREAK EVEN YIELD	17.20%
18	YIELD ON INVEST SEC (FTE)	13.76%
19	YIELD ON LOANS	14.69%
20	NET CHRG-OFFS % AV LOANS	0.66%

ENTER MORE OR DONE--> MORE

21	LOAN LOSS PROV % AV LOANS	5.81%
22	RATE ON TIME & SAVINGS	10.59%
23	RATE ON TOTAL INT FUNDS	10.60%
24	INT EXPENSE % EARN ASSETS	5.46%

CAPITAL POSITION

25	EFFECTIVE TAX RATE-OP INC	-37.68%
26	CASH DIV % OPER INC	0.00%
27	CAPITAL FORMATION RATIO	0.56%
28	EQUITY CAPITAL % ASSETS	45.50%

PRODUCTIVITY

29	EARNING ASSETS % ASSETS	84.75%
30	NON-INT CASH&DUE % ASSETS	.8.65%
31	NON-INT INC % NON-INT EXP	26.25%
32	PERSONNEL EXP/EMPLOYEE	$4,421
33	EMPLOYEES PER MILL ASSETS	3.59
34	NON-INT INC % SALARIES	127.21%

USE OF FUNDS
(% EARNING ASSETS)

35	INVESTMENT SECURITIES	0.38%
36	FED FUNDS SOLD	9.85%
37	TOTAL LOANS	85.68%
38	RESERVE FOR LOAN LOSS	3.57%
39	REAL ESTATE LOANS-RESID	0.22%
40	REAL ESTATE LOANS-OTHER	0.01%
41	COMM & INDUSTRIAL LOANS	0.00%
42	PERSONAL LOANS	5.36%
43	AGR/LEASE FIN/OTHER LOAN	83.68%

SOURCE OF FUNDS
(% EARNING ASSETS)

44	DEMAND DEPOSITS IPC♦	6.35%
45	PUB FUNDS DEMAND DEPS	0.05%
46	TOTAL DEMAND DEPOSITS♦	6.40%
47	SAVINGS DEPOSITS♦ IPC	6.20%
43	TIME DEPOSITS IPC♦	45.16%
49	PUB TIME & SAVG DEPS	0.15%
50	TOTAL TIME & SAVG DEPS	51.52%
51	MEMO: MONEY MARKET CDS	4.22%
52	MEMO: TIME DEPS OVR 100M	34.74%
53	FOREIGN DEPOSITS	0.00%
54	TOTAL DEPS (FGN & DOM)	57.92%
55	BORROWINGS	0.04%
56	NET LARGE LIABILITIES	24.92%
57	NON-RATE ASSET/LIAB GAP	48.43%

GROWTH STATISTICS

58	INCOME BEF SEC TRAN 1-YR	-76.01%
59	NET INCOME 1-YR	-76.01%
60	AVERAGE ASSETS 1-YR	107.64%
61	INCME BEF SEC TRANS 5-YR	151.68%
62	NET INCOME 5-YR	151.69%
63	AVERAGE ASSETS 5-YR	321.06%

♦ DOMESTIC ONLY

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ADDENDUM J

March 12, 1981

Mr. Robert C. Zimmer
Zimmer & Einhorn
Suite 370
2501 M Street, N.W.
Washington, D.C., 20037

Dear Mr. Zimmer:

This is to advise you that the Board has reviewed the status of your client, Associates First Capital Corporation ("Associates"), a subsidiary of Gulf & Western, under the Bank Holding Company Act of 1956, as amended ("Act"), following its acquisition of Fidelity National Bank, Concord, California ("FNB"). The Board's review is based upon your submissions to the Board, including a letter to Mr. Robert E. Mannion dated February 5, 1981, a copy of FNB's management policy statement dated September 1, 1980, and commitments made to the Comptroller of the Currency dated August 4 and 12, 1980.

The Board understands that FNB, a national bank, divested itself of all of its commercial loans prior to its acquisition by Associates. Associates commits that FNB will make no commercial loans, and in its management policy statement for FNB indicates that FNB will strictly limit its lending to loans for personal, family, household or chariable purposes. FNB intends to document its compliance with these commitments by requiring a statement from each loan applicant acknowledging the purpose of the loan and, if there is any question regarding a borrower's purpose, the loan will not be made without the prior approval of FNB's board of directors.

In order to separate completely its deposit-taking activities from any commercial lending activities of Associates and any of its affiliates, FNB will in no way supply or maintain the availability of funds to Associates or its affiliates except in the form of dividends payable to Associates (as well as certain transactions between FNB and affiliates pertaining primarily to payroll and employee benefits completed monthly on a fee basis). Associates will not permit any of its

nonbanking affiliates to enter into any extensions of credit or in lending or deposit relationships, joint ventures, or activities performed on a fee basis involving FNB, unless permitted by applicable statutes, rules, or regulations.

In addition, no commercial loan inquiries, opportunities or referrals will be directed by FNB to any affiliates of Associates and no deposits of FNB will be loaned to or used for the benefit of any activity of Associates, or its commercial operating subsidiary, Associates Commercial Corporation, or any other Associates activity which could be construed to involve commercial loans. FNB has charged its officers and management with the responsibility for implementing its management policies and has adopted a number of procedures to internally monitor compliance.

Under section 3(a)(1) of the Act (12 U.S.C. §1842(a) (1)), it is unlawful, except with prior Board approval, for any action to be taken that causes any company to become a bank holding company. Since a bank holding company is defined under the Act as any company that controls a "bank", Associates would have had to obtain the Board's prior approval to become a bank holding company before acquiring FNB, if FNB were a "bank" under the Act. The term "bank" is defined in section 2(c) of the Act (12 U.S.C. §1841(c)) to mean ". . . any institution. . . which (1) accepts deposits that the depositor has a legal right to withdraw on demand, and (2) engages in the business of making commercial loans."

Based upon the information contained in your submissions, it appears that FNB is not a "bank" within the meaning of section 2(c) of the Act, since it has divested itself of its commercial loan portfolio, has committed that it will not engage in commercial lending, and intends to limit its lending to loans to individuals for personal, family, household or charitable purposes. Moreover, it appears that FNB has made adequate provision to insure that its demand deposit-taking functions will remain separate from the commercial lending functions of its affiliates, based upon FNB's commitments that it will not supply or maintain the availability of funds (except through dividends) to any affiliate that makes commercial loans.

Based upon the above representations, the Board has concluded that FNB is not a "bank" within the meaning of section 2(c) of the Act, and therefore Associates was not required by the Act to obtain the Board's approval prior to its acquisition of FNB. This determination is based expressly upon the facts summarized herein and the commitments and representations contained in the correspondence referenced above and any material change therefrom could result in a different conclusion.

Very truly yours,
JAMES MCAFEE
Assistant Secretary of the Board

ADDENDUM K
American Banker, July 13, 1981

HOUSEHOLD FINANCE PARENT TO ENTER BANKING BY ACQUISITION

By James Rubenstein

CHICAGO—Household International Inc., a Chicago-based conglomerate and parent of Household Finance Corp., the nation's third largest consumer finance firm, announced plans last week to enter retail banking through the acquisition of a small California bank.

In the second bank-purchase agreement of its kind involving a consumer finance firm, Household said it seeks to acquire the $88.1 million deposit Valley National Bank, of Salinas.

Household said its planned acquisition of the bank, in a $20.3 million tender offer to shareholders, has already been approved by the Comptroller of the Currency.

Complying with a Federal Reserve Board ruling last March on such acquisitions by nonbank firms, Household said if the purchase is consummated it will divest Valley National's commercial portfolio and retain the institution as a "consumer bank."

In the March ruling,—also dealing with another small California bank, the $10 million-deposit Fidelity National Bank, of Concord—the Fed upheld its purchase by Associates First Capital Corp., the Dallas consumer finance subsidiary of Gulf & Western Corp.

The Comptroller had approved that acquisition in August 1980 provided Fidelity spin off its commercial banking operations, which it has since done.

Has 7 Branches

Valley National, founded in 1964, and located in central California, has assets of $98 million and operates seven branches in the Salinas-Monterey-Watsonville area.

In a formal statement put out by Household International, the diversified Prospect Heights, Ill., firm said Valley National "conducts normal banking operations but focuses on retail lending an deposits."

Household International is a Fortune 500 firm with $7 billion in assets controlling a diverse assortment of businesses ranging from plumbing fixtures to insurance.

It owns City Products Co., a large merchandiser, National Car Rental, Ben Franklin Stores, and last month required Wallace-Murray Corp.

Household Finance—with over 2,000 consumer loan offices—has capital funds of $1.58 billion.

Cash Tender Offer

On the Valley National purchase, Household International said it is extending a $65.50 cash tender offer for all of the 310,000 outstanding shares of the Salinas bank.

The announcement said directors of the bank have entered into an agreement with Household to sell 18% of shares owned by them and also have recommended the offer to shareholders.

"While today Household Finance operates some 35 units in the areas of merchandising, manufacturing, and transportation, we have remained dedicated to maintaining our leadership position in financial services through expansion and selected acquisitions," stated G.R. Ellis, chairman of the board and chief executive officer of Household International.

"Banking will not be new to us. We began HFC Trust Ltd. in the United Kingdom in 1973, and today we serve the U.K. through 107 offices of this consumer banking operation," said Household.

"This acquisition is designed to further HFC's goals of providing a full range of financial services to our customers," stated W.D. Hendry, president of Household Finance.

Household's "success" in this area "has led us to believe banking is an essential element of our plans to provide a totally comprehensive program of financial services," Mr. Hendry said.

Edward L. Evans, president of Valley National, said discussions with Household began eight months ago after his bank was chosen by the Chicago firm as the most suitable candidate for takeover.

"I think there were seven or eight other banks that showed up on somebody's screen, and through the process of elimination we were chosen," said Mr. Evans.

Aiding Household in the selection process was Morgan Guaranty Trust Co. of New York, through its investment advisory services which retain Household as a client, Mr. Evans said.

5-State Survey

As part of the "finding" process, Morgan Guaranty had conducted a survey of five states, Mr. Evans said.

Household, he said, apparently seeks to own a national bank "and pay this kind of price" to take advantage "of the deposit taking function."

Household already has a significant California base with 265 offices in the state with $600 million in loans, Mr. Evans said.

"Our bank is strategically located in the central part of the state and that may have been another factor in their thinking," he said.

In acquiring the Salinas bank, Mr. Evans surmised Household might seek to expand Valley National's seven branches into a statewide system.

Household may also have chosen to enter retail banking in this manner "to use our charge card operation."

Valley National offers both MasterCard and Visa with 8,000 accounts and a $2.5 million portfolio.

Under the agreement with Valley NB and in compliance with the Fed, Household will dispose of the bank's commercial assets which amount to 10% of the portfolio.

Valley NB can retain consumer leasing, direct consumer loans and real estate loans, said Mr. Evans.

The Salinas banker said another California bank would likely be a buyer of the commercial loans "but those arrangements are not known to us."

Mr. Evans, who has been president of the bank since its founding, said all of the bank's management intends to stay following the consumation of the transaction next month.

Application to acquire the bank was made with the Comptroller March 23 under the Change of Control Act with the 60-day waiting period expiring May 23, said a Household spokesman.

The Household tender offer expires Aug. 5. ■

ADDENDUM L

American Banker, September 30, 1982

FED ALLOWS CITICORP TO ACQUIRE FIDELITY

The Federal Reserve Board on Tuesday issued an order allowing Citicorp, New York, to acquire Fidelity Savings & Loan Association, San Francisco, adding several conditions designed to preserve Fidelity's character as a thrift. An appendix to the order will appear in the issue of Monday, Oct. 4.

Citicorp, New York, New York, a bank holding company within the meaning of the Bank Holding Company Act (the "BHC Act"), has applied for the Board's approval under section 4(c)(8) of the BHC Act (12 U.S.C. § 1843(c)(8)) and section 225.4(b)(2) of the Board's Regulation Y (12 C.F.R. §225.4(b)(2)), to acquire 100% of the voting shares of Fidelity Federal Savings & Loan Association of San Francisco, California ("Fidelity"), and its wholly-owned service corporation. Fidelity is a federally chartered and insured savings and loan association and is the successor by supervisory conversion of Fidelity Savings & Loan Association, San Francisco, California, a California guarantee stock savings and loan association, that was closed by the State of California on April 13, 1982, and placed under the receivership of the Federal Savings and Loan Insurance Corp. ("FSLIC"). (Fidelity is currently operated as a mutual association. In order to effect consummation of the proposal, Fidelity will be converted from a mutual association and issued a charter as a stock federal savings and loan assocaition.)

By letters, dated Aug. 13 and Sept. 8, 1982, the Federal Home Loan Bank Board ("FHLBB") requested that the Board act expeditiously upon this application in light of the emergency nature of the situation at Fidelity and its deteriorating financial condition. In light of this request, the Board promptly published notice of the application in the "Federal Register", providing 21 days for interested persons to comment on the application. In addition, in order to provide a full opportunity for public comment, the Board ordered informal hearings on the application in both Washing-

ton, D.C., and San Francisco, California, to receive comments and testimony from interested persons on the application and to allow interested persons to question Citicorp concerning its proposal.

In response to its request for comment on this application, the Board received 35 written comments opposing the acquisition ("protestants") and 11 favoring the acquisition. Ten general comments were received that did not take a position on the proposal. In addition, the Board received sworn testimony from 23 persons who appeared at the two hearings, as well as statements and other documents submitted by the participants at the hearings. As discussed below, a number of protestants requested that the Board order a formal hearing on the application.

The Board has carefully considered the issues raised by the protestants in writing or in oral testimony and, in the appendix attached to this order, which is an integral part hereof, the Board has analyzed these comments and evaluated their relevance to the Board's conclusions in light of the factors set forth in section 4(0)(8) of the BBC Act are elaborated in the appendix. Based upon the record before the Board in this matter, the Board makes the following findings.

Citicorp, with total consolidated assets of $120.1 billion and deposits of $74.5 billion, is the second largest banking organization in United States. (Unless otherwise indicated, all financial data are as of June 30, 1982.) Citicorp operates three subsidiary banks: Citibank, N.A., New York, New York ("Citibank"), the second largest commercial bank in New York with $21.9 billion in domestic deposits, representing 12.3% of the deposits in commercial banks in New York (as of June 30, 1981) Citibank (New York State) NA, Buffalo, New York; and Citibank South Dakota, Sioux Falls, S.D. (Citicorp received Board approval on July 21, 1982, to acquire Citibank (Delaware), Wilmington, Delaware, a proposed new bank. Citicorp. 68 Federal Reserve Bulletin 499 (1982).)

Citicorp also controls numerous nonbanking subsidiaries located throughout the United States, including subsidiaries engaged in consumer lending, mortgage lending mortgage

servicing, industrial banking and commercial lending in California.

Fidelity is a savings and loan association headquartered in San Francisco, California, which operates 81 offices in California, primarily in the San Francisco area, and has regulatory approval for three additional offices. Fidelity, with total assets of $2.9 billion, is the 16th largest savings and loan association in California and the 42d largest in the United States. Fidelity is primarily engaged in taking savings deposits and making loans to individuals secured by mortgages on real property. Fidelity also owns a service corporation that operates in the states of Hawaii and Nevada and that engages in the activities of mortgage lending, real estate development, and the sale and leasing of equipment to Fidelity.

Citicorp's banking subsidaries and Fidelity operate in separate markets. Fidelity operates in 10 California SMSAS, where it controls from 0.24% to 3.7% of the total deposits in commercial banks and savings and loan associations in those markets. (Fidelity's highest market shares of 3.7% is in the Vallejo-Fairfield-Napa SMSA, where it ranks as the sixth largest depository institution.) Citicorp operates approximately 20 offices of its nonbank subsidiaries in California, including industrial loan company offices that engage in limited deposit-taking activities.

Those offices that engage in the same activities as Fidelity have only insignificant market shares and are located primarily in southern California, whereas Fidelity is located primarily in Northern California. For example, in originating first mortgages, Citicorp and Fidelity together account for less than 1.5% of the total volume of mortgages originated in California. Citicorp's share of deposits among all deposit-taking institutions in California is also insignificant.

Citicorp's application to acquire Fidelity was filed and has been considered by the Board under section 4(c)(8) of the BHC Act, which deals with the permissible nonbanking activities of a bank holding company. As explained in the appendix to this order, the Board believes that a federally insured savings and loan association that offers NOW accounts

and that exercises no greater commercial lending powers than are now permitted to federally insured savings and loan association under the Home Owners' Loan Act ("HOLA") is not a bank for purposes of the BBC Act. In this connection, the board also notes that the acquisition and ownership of Fidelity is subject to the Savings and Loan Holding Company Act Act Amendments of 1967 (SELHC Act). Thus the Board concludes that Fidelity is not a "bank" under the BHC Act, that Citicorp's application is properly filed under section 4 of the BHC Act, and that the interstate banking prohibition of section (d) of the BHC Act does not bar Board approval of this application.

Section 4(c) (8) of the BHC authorizes a bank holding company to acquire a nonbank company if the activities of the nonbank company are determined by the Board to be "so closely related to banking or managing or controlling anks as to be proper incident thereto. The Board has determined previously that the operation of a savings and loan association is closely related to banking and reaffirms that determination in this order. (American Fletcher Corp., '60 Federal Reserve Bulletin 868 (1974), D.H. Baldwin & Co., 63 Federal Reserve Bulletin 280 (1977); Interstate Financial Corp., 6B Federal Reserve Bulletin 316 (1982). A recent Board staff study of thrift institutions supports the view that operating a thrift institution is closely related to banking. Bank Holding company acquisitions of Thrift Institutions, September 1981.)

With respect to the proper incident requirement, section 4(c) (8) of the BHC Act requires the Board to consider whether the performance of the activity by an affiliate of a bank holding company "can reasonably be expected to produce benefits to the public, such as greater convenience, increased competition, or gain in efficiency that outweigh possible adverse effects, such as undue concentration of resources, decreased or unfair competition, conflicts of interests, or unsound banking practices."

In 1977, the Board considered the general question whether savings and loan association ("S&L") activities are a proper incident to banking. At that time, the Board determined that, as a general matter, S&L activities were not a

proper incident to banking since the potential adverse effects of generally allowing affiliations of banks and savings and loan associations were then sufficiently strong to outweigh such public benefits as might result in indvidual cases. D.H. Baldwin & Co., 63 Federal Reserve Bulletin 280 (1977).

Because of the considerations elaborated in D.H. Balwin & Co., the Board has not been prepared to permit bank holding companies to acquire thrift institutions on a general basis. However, the Board has consistently regarded the BHC as authorizing the Board to permit such an acquisition. As the problems of the thrift industry began to become more acute in 1981, the Board advised Congress that, in the absence of enactment of emergency thrift acquisition legislation, the public interest might dictate that the Board use its existing authority under BHC Act to approve interindustry acquisitions on a case-by-case basis. The Board indicated that, in the case of a failing thrift institution, any adverse effects of a bank holding company affiliation with a thrift might be overcome by the public benefits associated with preserving the failing institution. In April of this year, the Board approved such an application in order to prevent the failure of a thrift institution.

In a letter, dated Aug. 13, 1982, FHLBB chairman Richard Pratt informed the Board that the FHLBB had selected Citicorp as the winning bidder for Fidelity and urged the Board to act promptly on the Citicorp application in view of the deteriorating financial condition of Fidelity and its continued need for assistance. In a further letter of September 8, 1982 chairman Pratt advised the Board that there is no evidence that the rate of decline in Fidelity's position will slow or that its condition can improve unless it is acquiried by an instiution with greatly superior resources that can rebuild public confidence in the institution.

Fidelity's predecessor will placed in receivership on April 13, 1982, more than five months ago, and Fidelity's condition has steadily deteriorated since that time. Fidelity continues to lose deposits at a rate in excess of $1 million per day and to experience operating losses, estimated at over $200,000 per day. Fidelity has now exhausted its net worth and, as contemplated at the time the FHLBB authorized the FSLIC

to transfer the assets and liabilities of Fidelity's predecessor to Fidelity, Fidelity's net worth will be maintained by advance from the FSLIC, absent consummation of Citicorp's proposal.

In view of the determination by the FHLBB, the primary suervisory authority for Fidelity, with respect to the emergency financial condition at Fidelity, the substantial savings to the FSLIC through the Citicorp proposal, the present curcumstances of the thrift industry and the financial condition of a large number of its members, and the other favorable public benefit considerations listed in the appendix, the Board has determined that consummation of the Citicorp proposal, as specifically conditioned in this order, may reasonably be expected to result in substantial public benefits. These benefits include increased competition and greater convenience to the public through the restoration of Fidelity as an effective competitor and through Citicorp's stated commitments to meet the credit needs of Fidelity's communities. In its evaluation of the public benefits in this case, the Board also has taken into account the beneficial effect on the financial community as a whole of implementing an additional mechanism for the solution of the difficult problems for the thrift industry and the federal insurance funds posed by the poor earnings situation of this industry.

In the exercise of its responsibility under the BHC Act, the Board has carefully considered whether Citicorp's financial and managerial resources are adequate to effect the proposed acquisition of Fidelity. The Board notes that Citicorp has extensive experience in both the consumer banking and consumer finance areas and appears fully capable of revitalizing a consumer-oriented depository institution such as Fidelity. In its evaluation fo Citicorp's financial resources, the Board has reviewed relevant data from Citicorp's inspection reports and the examination reports of its subsidiaries as well as official reports and filings with the Board, including data on Citicorp's loan portfolio.

Based upon this review, the Board concludes that the proposed acquisition would not represent a significant additional burden on Citicorp's financial resources, particularly in view of Fidelity's size in relation to that of Citicorp. Although the

Board has noted, with respect to both Citicorp and other large multinational banks, a long-term trend toward lower capital ratios, the Board also has taken into account as a favorable factor the improvement in Citicorp's capital over the past one and one-half years and recent improvement in its earnings. The Board expects that Citicorp will continue its efforts to improve its capital position and will take such efforts into consideration in acting on applications for further expansion of Citicorp's activities. On balance, the Board concludes that Citicorp has both the financial and managerial resources needed to acquire Fidelity and make it viable competitor without significant adverse effects on Citicorp.

As explained in the appendix, the Board has re-examined, in the context of this application, the general adverse factors cited in the Board's D.H. Baldwin decision, including regulatory conflict, erosion of institutional rivalry and the potential for undermining interstate bank prohibitions, has determined that these adverse effects are outweighed by the substantial public benefits that are expected to result from the restoration of Fidelity as an effective competitor.

In addition, the Board has considered other possible adverse effects that might be associated with this particular application, including the potential for decreased or unfair competition, conflicts of interests, financial risks, diversion of funds, participation in impermissible activities, evasion of interest rate limitations, unsound banking practices, and undue concentration of resources.

In view of Citicorp's limted presence in the relevant California markets served by Fidelity, the number and size of financial organizations operating in these California markets, the legal prohibitions against Citicorp's expansion of its bank subsidiaries into California, and the fact that Fidelity is a failing insitution with limited competitive vigor, the Board concludes that his proposal would not have any significant adverse effects on existing or potential competition in any relevant market. Indeed, the proposed acquisition will have a substantial beneficial impact on competition by insuring the continued operation of Fidelity as a viable institution through access to the financial and managerial resources of Citicorp.

The affiliation of Citicorp and Fidelity also is not likely to result in unfair competition in view of the various conditions imposed by the Board that required Fidelity to be operated independently and not utilized to further or enhance the activities of Citcorp's other subsidiaries. In addition, Fidelity's activities will be limited to those permissible under the BHC Act and its offices will be limited to locations at which banks located in California may extablish branches.

To guard against possible adverse effects of affiliation in this case between a banking organization and a savings and loan association, including the potential for unfair competition and diversion of funds, the Board has established the following conditions for its approval of the application:

1. Citicorp shall operate Fidelity as a federal savings and loan association having as its primary purpose the provision of residential housing credit. Fidelity shall limit its activities to those permitted to federal savings and loan associations currently under the Home Owners' Loan Act and to bank holding companies and their subsidiaries under section 4(c)(8) of the Bank Holding Company Act. These limitations shall apply to Fidelity's wholly owned service corporation, Fidelity Subsidiary Corp., which sall have two years from the date of this order to complete the divestiture of its impermissible real estate development projects.

2. Fidelity shall not establish or operate a remote service unit at any location outside California.

3. Fidelity shall not establish or operate branches at locations not permissible for national or state banks located in California. (The Federal Reserve Bank of New York is hereby delegated authority to act on applications by Citicorp to open additional offices of Fidelity under section 225.4(b)(1) of Regulation Y.)

4. Fidelity shall be operated as a separate, independent, profit-oriented corporate entity and shall not be operated in tandem with any other subsidiary of Citicorp. Citicorp and Fidelity shall limit their operation to effect this condition, and shall observe the following conditions:

a. No banking or other subsidiary of Citicorp shall link its deposit-taking activities to accounts at Fidelity in a sweeping arrangement or similar arrangement.

b. Neither Citicorp nor any of its subsidiaries shall solicit deposits or loans for Fidelity; nor shall Fidelity, directly or indirectly, solicit deposits or loans for any other subsidiary of Citicorp.

To the extent necessary to ensure independent operation of Fidelity and prevent the improper diversion of funds, there shall be not transactions between Fidelity and Citicorp or any of its subsidiaries without the prior approval of the Federal Reserve Bank of New York. This limitation encompasses the transfer, purchase, sale, or loan of any assets or liabilities, but does not include infusions of capital from Citicorp or payment of dividends by Fidelity to Citicorp. (The board does not consider any extension of credit by Citicorp to Fidelity that is necessary to maintain Fidelity's liquidity or general financial integrity to be covered by this limitation.)

6. Citicorp shall not change Fidelity's name to include the work "bank" or any other term that might confuse the public regarding Fidelity's status as a nonbank thrift institution.

7. Fidelity shall not convert its charter to that of a state savings and loan association or other state-chartered thrift institution or to a national or state commercial bank without the board's prior approval.

The board concludes that consumation of the proposal, subject to the conditions set out in this order and the appendix thereto, may not reasonably be expected to result in conflicts of interests, unsound banking practives, undue concentration of resources, or other adverse effects.

The board also has considered the contention that the FSLIC erred in not accepting a bid from one of the California savings and loan associations that bid for Fidelity. The selection of the most favorable bid for Fidelity is a matter committed to the jurisdiction of the FSLIC, and the board concludes that proper administration of the law requires that there should be only one administrative decision on this issue.

The law assigns to the board the responsibility under section 4(c)(8) of the BHC Act for a determination of the public benefits and adverse effects of the application before it—the

Citicorp application—and the board has discharged that responsibility in this order.

Based upon the foregoing and other facts and circumstances reflected in the record and as more fully set forth in the appendix, the board has determined that the acquisition of Fidelity by Citicorp would result in substantial and compelling public benefits that are sufficient to outweigh any adverse effect that may reasonably be expected to result from this proposal, including any potential adverse effects of the affiliation of a commercial banking organization with a thrift institution. Accordingly, the application is approved subject to the conditions and limitations described in this order, the appendix hereto, and the record of this application.

The board has also considered the requests of a number of commenters that the board delay action on the application in order to allow for congressional action on bills now pending before Congress that, if enacted, would establish specific procedures for acquisition of a failing thrift institution by a bank holding company across state lines.

Moreover, the Federal Home Loan Bank Board has advised that the procedures utilized in the Fidelity bidding process generally complied with the terms of these bills; that an extensive attempt, over a long period of time, was made to find interested and capable bidders from within the industry; and that a broad range of bidders, including banks and savings and loan associations, were initially invited to bid, that a rebidding was organized at which California financial institutions were given an opportunity to better or equal Citicorp's bid; and that, accordingly, the basic concepts contained in both versions of these bills were embodied in the procedure by which the FSLIC decided to accept the Citicorp proposal.

In view of these considerations, the board's established legal authority to authorize the acquisition, the request of the FHLBB for expedited treatment of the application in view of the emergency situation of Fidelity, the clear public benefits of the application, and the costs and uncertainties of delay, the board has determined that it would not be in the public interest to delay a decision on the application.

The board has also carefully considered the requests of several protesters that the board hold a formal hearing regarding this proposal. For the reasons specified in the appendix to this order, the board does not believe a formal hearing is required or appropriate in this case and, accordingly, denies the requests of the protesters for a formal hearing.

Several protesters have requested that, in the event the board approves the proposed acquisition, the board stay the effective date of the approval pending judicial review of the board's action. The board has reviewed these requests in light of the factors generally applied by the courts on stay requests and, based upon that review as explained in the appendix to this order, does not believe that a stay of the board's order in this case is appropriate or in the public interest. Accordingly, the board hereby denies protesters' request for a stay of the board's order.

By order of the Board of Governors, effective Sept. 28, 1982.

JAMES MCAFEE
Associate Secretary of the Board

ADDENDUM M

APPENDIX TO FED RULING ON CITICORP ACQUISITION OF FIDELITY

American Banker
October 4, 1982

The following is the appendix to the Federal Reserve Board order approving the acquisition by Citicorp of Fidelity Savings of San Francisco. In the appendix, the Fed addresses the issues raised by the bank holding company's purchase of the savings and loan association. The order itself was published in the Sept. 30 American Banker.

In connection with its decision on the application of Citicorp under section 4(c)(8) of the Bank Holding Company Act to acquire Fidelity Federal Savings & Loan Association of San Francisco, the board issues the following statement containing additional findings of fact and conclusions of law with respect to, and the board's analysis of the issues raised by, the application and the comments received.

(Among the protesters to the application were the Independent Bankers Association of America, the United States League of Savings Associations, the California Bankers Associations, the California Savings and Loan League, and the Conference of State Bank Supervisors. The California financial institutions supervisory authorities also appeared at the informal hearing in San Francisco to express their concerns with the application and to urge delay of any board decision pending congressional action on emergency thrify acquisition legislation. The state representatives expressed concern over the interstate nature of the acquisition as well as the impact it might have on California financial institutions and indicated that the board should hold a formal hearing to explore and evaluate these questions.)

Fidelity's Status as a Nonbank

In its evaluation of the application, the board considered the objections of a number of the protesters that Fidelity should be regarded as a "bank" for purposes of the Bank Holding Company Act; that Citicorp's application to acquire

Fidelity was, therefore, improperly filed under the nonbank provisions of section 4(c)(8) of th BHC Act and should have been filed, and should be considered by the board, under section 3 of the BHC Act, which requires prior board approval before a bank holding company such as Citicorp may acquire control of a bank; and that, because Fidelity is a bank, board approval of its acquisition by an out-of-state bank holding company such as Citicorp is barred by section 3(d) of the BHC Act. (12 U.S.C. §1842(d).)

Section 3(d) prohibits the board from approving an application by a bank holding company to acquire an interest in a bank located outside of the state in which the operations of the bank holding company's subsidiary banks are principally conducted (in Citicorp's case, the state of New York), unless such an acquisition is expressly permitted by the law of the state in which the acquired bank is located.

The BHC Act defines a bank as an institution that accepts deposits that the depositor has a legal right to withdraw on demand and that is engaged in the business of making commercial loans. (12 U.S.C. § 1841 (c))

As a federal savings and loan association, Fidelity is authorized to offer negotiable order of withdrawal accounts and to engage in certain limited commercial lending activities. (12 U.S.C. §§1464(b) and (c) and 1832. Fidelity offers NOW accounts and has outstanding about $190 million in commercial real estate loans, representing about 6% of Fidelity's total assets.)

Based on the terms and legislative history of the BHC Act, the board has previously determined that, because of the checklike powers of NOW accounts and because they generally perform the same function as demand deposits, NOW accounts satisfy the demand deposit test in the definition of "bank" in the BHC Act. (First Bancorp., 68 Federal Reserve Bulletin 253 (1982).)

As indicated, the Board believes that a federally insured savings and loan association that offers NOW accounts and exercises no greater commercial lending powers than are now permitted to a federal savings and loan association under the Home Owners' Loan Act of 1933 as amended is not a "bank" for purposes of the BHC Act. (First Bancorp., 68

Federal Reserve Bulletin 253 (1982); Interstate Financial Corp., 68 Federal Reserve Bulletin 316 (1982). The industrial loan company involved in First Bancorp. offered NOW accounts and made commercial loans in excess of the amount permitted to a federal thrift. Consequently, the board concluded that it was "bank" for purposes fo the BHC Act. On the other hand, the state-chartered and insured savings and loan association in Interstate did not make commercial loans and committed to secure FSLIC insurance, and thus the Board determined that it was not a "bank.")

In reaching this decision, the board has relied on the fact that the lending activities of federal savings and loan associations have historically been highly specialized and, under current statutory and regulatory provisions, continue to be concentrated in home mortgages. The Home Owners' Loan Act expressly provides that the primary purpose of a federally chartered savings and loan association is the provision of residential credit. (12 U.S.C. § 1464. Under the Home Owners' Loan Act, a federal savings and loan association is not permitted to engage in general commercial lending. It may, however, invest up to 20% of its assets in commercial real estate loans and may invest an additional 20% of its assets in commercial paper. 12 U.S.C. § 1464(c)(2)(A) and (B). Fidelity's current loan portfolio appears permissible under the Home Owners' Loan Act.)

In this regard, the board also notes that Congress has designed a separate and independent statutory structure for the regulation of federally insured savings and loan associations and their holding companies. While Congress has recently permitted federal savings and loan associations to engage in limited nonresidential mortgage lending, Congress has left intact a separate statutory and regulatory framework for the operation and ownership of federally insured savings and loan associations and banks.

In the board's view, this provide a strong indication of congressional intent that federally insured savings and loan associations are included within the definition of "thrift institution" under section 2(i) of the BHC Act (12 U.S.C. §1841(i)). This differentiation between banks and thrift institutions in the definitional sections of the BHC Act provides

additional support for the conclusion that federal savings and loan associations that engage in activities no broader than permitted by the terms of the Home Owners' Loan Act are not "banks" within the meaning of the BHC Act. (The board notes that Congress has under consideration legislation that would expand the commercial lending authority of federal savings and loan associations and that would specifically exempt an association exercising such expanded commercial lending authority from the definition of a bank in the BHC Act. S.2879, 97th Cong., 2d Sess. S 333 (1982).

For these reasons, the Board concludes that Fidelity is not a bank under the BHC Act and its acquisition by Citicorp is not barred by section 3(d) of the BHC Act.

(The nonbank provisions of section 4 of the BHC Act do not have an interstate prohibition similar to that in section 3(d) of the BHC Act. Lewis v. BT Investment Managers Inc., 447 U.S. 27 (1980.) There is a provision in the Savings and Loan Holding Company Act that pervents a savings and loan holding company from acquiring an interest in an insured institution that would result in the formation of a multiple savings and loan holding company controlling an "insured institution" in more than one state (12 U.S.C. §1730a(e)(3). Since none of Citicorp's currently-owned bank or nonbank subsidiaries is included within the definition of "insured institution" under the S&L Holding Company Act, the proposed acquisition does not violate this prohibition.

(Several protesters have claimed that Fidelity will be operated as a branch of Citicorp's subsidiary banks and thereby violate the McFadden Act prohibitions against interstate branching (12 U.S.C. §36). The Board has considered this claim and finds that Fidelity will not take deposits or solicit or make loans on behalf of any Citicorp subsidiary bank.

(In addition, Fidelity will be operated separately and independently from Citicorp's bank subsidiaries and, as noted in the order, the board has imposed conditions to ensure such separate operation and to prevent tandem operations.

(On this basis, the board concludes that Fidelity will not be operated as a branch of any Citicorp subsidiary bank and its operation as a subsidiary of Citicorp will not contravene the McFadden Act.)

As noted, the board has required, as a condition of its approval, that Citicorp maintain Fidelity as a federal savings and loan association subject to the restrictions of the Home Owners' Loan Act. An expansion of Fidelity's activities beyond that now permitted to a federal savings and loan association would represent a significant alteration of Fidelity's activities and would require prior board approval under section 225.4(c) of Regulation Y (12 C.F.R. § 225.4(c)).

Closely Related to Banking

Section 4 of the BHC Act generally prohibits a bank holding company from engaging, either directly or through a subsidiary, in nonbanking activities, that is, in activities other than those of banking or managing or controlling banks. (12 U.S.C. §1843 (a)(2)) The principal exception to this prohibition is contained in section 4(c)(8) of the BHC Act, which authorizes a bank holding company to acquire a company engaged in activities that "the board after due notice and opportunity for hearing has determined (by order or regulation) to be so closely related to banking . . . as to be a proper incident hereto. (12 U.S.C. § 1843 (c)(8)) In making the determination of whether an activity is a proper incident to banking, section 4(c)(8) requires that: The Board shall consider whether its performance by an affiliate of a holding company can reasonably be expected to produce benefits to the public, such as greater convenience, increased competition, or gains in efficiency, that outweigh possible adverse effects, such as undue concentration of resources, decreased or unfair competition, con___ of interests, or unsound banking practices.

Section 4(c)(8) thus requires the board to make two separate findings in order for a nonbanking activity to be permissible for a bank holding company. (National Courier Association v. Board of Governors, 516 F.2d 1229, 1232-1233 (D.C. Cir. 1975).) First, the board must determine whether the activity is "closely related to banking," that is, whether as a general matter the activity is permissible for bank holding companies. Second, the board must determine whether the performance of the proposed activity by an applicant bank holding company may reasonably be expected to produce public benefits that outweigh possible adverse effects.

On a number of occasions over the past 10 years, the board has considered, both in the context of a rule-making proceeding and specific applications, whether the operation of a savings and can association by a bank holding company is a permissible activity for a bank holding company under the close-related and proper incident tests in section 4(c)(8) of the BHC Act. Newport Savings & Loan Association, 58 Federal Reserve Bulletin 313 (1972); American Fletcher Corp., 60 Federal Reserve Bulletin 868 (1974).) In 1974, the board concluded, on the basis of a record compiled after notice and a rulemaking hearing in which numerous parties participated, that the operation of a savings and loan association is closely related to banking within the meaning of section 4(c)(8) of the act.

The board, however, denied the application because the applicant failed to demonstrate that it could satisfy the proper incident to banking test, that is, that the reasonably expected public benefits of the proposal outweighed possible adverse effects. (In American Fletcher Corp., the board denied on the basis of adverse financial conditions.) In a number of cases decided since that time, the board has consistently held to the position that the operation of a savings and loan association is closely related to banking. (E.g., Memphis Trust Co., 61 Federal Reserve Bulletin 327 (1975); D.H. Baldwin & Co., 63 Federal Reserve Bulletin 280 (1977); Interstate Financial Corp., 68 Federal Reserve Bulletin 316 (1982).)

In this case, the board reaffirms its view as expressed in American Fletcher Corp. and in other decisions that the operation of a savings and loan association is an activity that is closely related to banking. Both banks and savings and loan associations are financial intermediaries with liability structures dominated by loans. The traditional deposit-taking and lending activities of savings and loan associations are functionally and operationally similar to activities performed by banks and require the same type of analysis and expertise.

While the board believes that the operation of a savings and loan association is an activity that is closely related to banking, in order to approve such an activity for a bank holding company, the board must also find that the proposal

meets the proper incident to banking test of section 4(c)(8) of the BHC Act.

Proper Incident to Banking

In 1977, the board considered the general question of whether the operating of a savings and loans association is a proper incident to banking. At that time and on the basis of the factual record presented in that case, the board determined that, as a general matter, such an activity is not a proper incident to banking since the potential adverse effects of allowing affiliations between banks and savings and loan associations on a general basis were sufficiently strong to outweigh the public benefits that might result in individual cases. D.H. Baldwin & Co., 63 Federal Reserve Bulletin 280 (1977).

In the Baldwin case, the board identified three potential adverse effects that could be expected to result from the affiliation of a bank and a savings and loan association: the conflict between the statutory and regulatory frameworks within which banks and savings and loans operate; the erosion of institutional rivalry between banks and savings and loans; and the potential for understanding federal prohibitions against interstate banking.

Based upon competitive considerations and these generalized adverse effects, and in the absence of any compelling public benefits, the board denied the application. In subsequent years, the board approved a number of applications by bank holding companies in New Hampshire to acquire thrift associations but only on the basis of the historical affiliations between banks and thrifts in that state and certain structural and competitive considerations of that affiliation. (E.g., First Financial Group of New Hampshire, 66 Federal Reserve Bulletin 594 (1980). On this same basis, the board had earlier approved applications by bank holding companies to acquire thrifts in the state of Rhode Island. See, e.g.,—Old Colony Cooperative Bank, 58 Federal Reserve Bulletin 417 (1972).)

In 1982, in Interstate Financial Corp., 68 Federal Reserve Bulletin 316 (1982), the board was called upon for the first time to determine whether the adverse effects identified in the Baldwin decision could be offset by the benefits to the

public associated with preserving a financially troubled savings and loan association. In Interstate, the Ohio superintendent of building and loan associations requested the board to consider the application on an expedited basis in view of the facts that the association had nearly depleted its capital and under Ohio law its liquidation would have been required in the near future.

While specifically stating that it did not overrule its conclusion in Baldwin that, as a general matter, the operation of a savings and loan association by a bank holding company is not a proper incident to banking, the board concluded, on the basis of the specific facts in the Interstate case, that the public benefits of preserving the savings and loan association as a viable competitor were so substantial as to outweigh the adverse effects of the interindustry affiliation.

In analyzing the public benefits of the proposal, the board considered the financial conditions facing the thrift industry generally, the financial condition of a number of its members, the lack of any other viable alternative to address the association's financial condition, the request of the Ohio supervisory authorities for prompt action, and the potential ramifications of a liquidation of the association on the association's customers, the depositing public, the state of Ohio, and the Ohio Deposit Guarantee Fund.

D. H. Baldwin Case

In its consideration of the proper incident test in connection with this application, the board has reexamined each of the potential adverse factors found in Baldwin.

With regard to the potential for regulatory conflict, Citicorp is currently a bank holding company and is therefore subject to the provisions of the BHC Act. Fidelity, as a federal savings and loan association, is subject to the provisions of the Home Owners' Loan Act. In order to reduce the potential for conflict between the BHC Act and loan act, the board conditions approval of this application upon Fidelity's activities being limited to those that are permitted both to federal thrift institutions currently under the loan act and to bank holding companies and their nonbank subsidiaries under section 4(c)(8) of the BHC Act. (In the event Fidelity intends to engage, directly or through a service corporation, in

any additional nonbanking activity not covered by this application, Citicorp covered by this application, Citicorp and Fidelity would be required to obtain the board's approval under section 4(c)(8) of the BHC Act and section 225.4 of Regulation Y. This application covers the traditional deposit-taking and lending activities of federal savings and loan associations as currently authorized under the loan act, mortgage brokering, loan servicing, and mortgage lending.)

This condition does not limit the performance of the traditional deposit-taking and lending activities of federal savings and loan associations by Fidelity.

(In its D.H. Baldwin decision, the board expressed concern that a condition that limited the activities of a savings and loan association owned by a bank holding company would place the association at a competitive disadvantage and prevent the full realization of public benefits that are expected from the operation of the association. Indeed, the Federal Home Loan Bank Board had opposed the acquisition of a savings and loan by a bank holding company on this basis.

(While the board recognizes that Fidelity's affiliation with Citicorp will limit Fidelity's ability to offer all services authorized under the loan act, the affiliation will restore Fidelity to a viable competitive position and allow it to continue to offer most authorized services. These benefits are, in the board's judgment, more than sufficient to outweigh the fact that Fidelity may no longer engage in real estate development and similar impermissible activities under the BHC Act, activities that represent only a small fraction of Fidelity's overall operations.

(In this regard, Citicorp has indicated it has no desire to engage in such activities but intends to promote Fidelity's basic consumer-oriented services. The board also notes that the FHLBB has urged approval of the application as providing substantial public benefits through the restoration of Fidelity as an active competitor that outweigh any possible adverse effects.)

Upon consummation of the proposal, Citicorp will become a savings and loan holding company under the S&L Holding Company Act. (12 U.S.C. § 1730a.) As a savings and loan

holding company and a bank holding company, Citicorp will be required to conform its activities to the requirements of both statutes.

As a unitary savings and loan holding company, Citicorp is prohibited from engaging in any activity that would have the effect of evading a law or regulation applicable to an insured savings and loan association 12 U.S.C. § 1730a(c)(1). (The FHLBB has granted a waiver to Citicorp of the restrictions on the amount of debt that can be incurred by a nondiversified savings and loan holding company (12 U.S.C. § 1730a-(g)).

In the board's view, Citicorp will be able to continue its bank holding company and commercial bank operations without conflict with the S&L Holding Company Act or the Home Owners' Loan Act.

In view of the above, the board concludes that while some adverse consequences may result because of regulatory conflicts between the BHC Act, the Home Owners' Loan Act, and the S&L HC Act, these adverse effects are mitigated by the conditions imposed in this order to require Citicorp's compliance with the terms of each statute and, as discussed below, to prevent any unfair competitive advantage accruing to Citicorp or Fidelity by reason of the affiliation.

The board also continues to believe that, as a general matter, the affiliation between banks and thrifts may produce possible adverse effects by diminishing the interindustry rivalry that has produced price and service benefits to the public and by undermining the prohibition of the BHC Act against interstate banking. However, these adverse effects, in the context of this case, are substantially mitigated by the fact that Fidelity is a failing institution that has lost its competitive vigor and is able to continue operations only through substantial federal financial assistance.

As discussed below, the board believes that the revitalization of and restoration of public confidence in Fidelity is a public benefit that, along with other public benefits, outweighs any adverse effects that may result from consummation of the proposal.

Moreover, to ameliorate further the possibie adverse effects of affiliation in this case between a banking organization and a thrift association, the board has conditioned approval of the proposal to require that Fidelity continue to be operated as a savings and loan association having as its primary purpose the provision of residential credit, that its offices be confined to California, and that Fidelity and Citicorp's subsidiaries be operated separately and independently of one another. The board believes that such restrictions will minimize the potential for erosion of statutory prohibitions against interstate banking and maintain the independence and specialized function of the savings and loan industry.

Other Possible Adverse Effects

As discussed below, the board in its evaluation of the application has also considered the potential for additional adverse effects that might result from consummation of Citicorp's particular proposal, including the potential for decreased or unfair competition, conflicts of interest, financial risks, diversion of funds, participation in impermissible nonbanking activities, evasion of interest-rate limitations, and undue concentration of resources.

In this connection, the board considered the contentions of the protesters that, in addition to the general effects cited by the board in Baldwin, the following addverse effects may result from consummation of the Citicorp proposal: (1) The acquisition would result in a major restructuring of the financial services industry, and Citicorp would obtain an unfair competitive advantage over commercial banks andd thrift organizations that are not afforded the combination in one organization of thrift and commercial banking powers; (2) decreased or unfair competition would result because Citicorp's substantial resources would enable it to strengthen the competitive position of Fidelity to the detriment of the already weakened thrift industry in California; (3) Citicorp would operate Fidelity in tandem with its banking and other subsidiaries through the use of Fidelity's deposits to fund Citicorp's other activities or through the use of Citicorp's other subsidiaries to attract deposits to Fidelity; (4) Citicorp may not have the financial ability and resources to operate and revitalize Fidelity; and (5) the transaction would result in an undue concentration of resources.

Protesters also allege that other adverse considerations warrant denial of Citicorp's proposal, namely, (1) the procedures utilized by the FSLIC in the bidding process for Fidelity were unfair, and the Citicorp offer for Fidelity was not the offer most favorable to the FSLIC and the public; (2) no emergency situation exists at Fidelity in that it is no longer a failing institution now that it is under FSLIC receivership; and (3) the Citicorp proposal is not the only available alternative to address Fidelity's situation and thus does not qualify for approval under the criteria cited by the board in its Interstate decision.

Unfair Competition

The board does not believe that the evidence of record in this case supports the proposition that the acquisition would result in a major restructuring of the financial services industry. On the contrary, the board believes that the proposed acquisition, in light of Citicorp's commitments and the conditions imposed by the board in this order, will result in the operation of two independent and different types of depository institutions supported by the financial and managerial strength of a parent holding company that will permit these organizations to provide substantial public benefits in their respective product and geographic markets.

Citicorp has filed an application to acquire and operate a savings and loan association in California and has stated that it will operate Fidelity independently of its commercial banking activities.

The board has considered the application only on the basis and its approval as conditioned by this order is designed to ensure that Fidelity will be operated as a savings and loan association and will continue to serve the specialized purpose for which it was organized and will not be utilized to further or enhance the activities of Citicorp's subsidiary banks.

The board has given careful consideration to the contention that Citicorp will obtain an unfair competitive advantage over commercial banks through affiliation with a savings and loan association that may engage in activities that are not authorized for banks e.g., certain service corporation activities).

To address these concerns, the board has limited Fidelity activities to those permissible for bank holding companies under the BHC Act and to locations at which banks located in California could establish branches. As the board has previously held, the BHC Act requires that the activities of a thrift institution that is acquired by a bank holding company must be limited to those permissible under the BBC Act.

Activity Limited

In conformance with that holding the board's approval of this application does not authorize Citicorp to engage in any activity through Fidelity that is not permissible under section 4(c)(8) of the BHC Act.

(This requirement is also applicable to activities performed by Fidelity through a service corporation. The board has previously held that, under the BBC Act, a bank holding company subsidiary may not perform indirectly through a service corporation an activity that is impermissible for the bank holding company. Fidelity's service corporation, therefore, must terminate all activities that are not permissile under the BHC Act.)

(Fidelity currently is engaged, through its service corporation, in a number of real estate development projects, an activity that is not permissible for a bank holding company. In accordance with Citicorp's commitments and the terms of this order, Fidelity may not engage in any additional real estate development projects either directly or through a service corporation. In order to afford Fidelity a reasonable period of time to divest currently held impermissible assets and in view of the fact that such assets consist primarily of real estate projects, the board has provided a two-year divestiture period for such assets.)

In addition, this order does not authorize Fidelity to perform any activity that is not permitted to a federal savings and loan association under the HOLA. As a condition of this order, Fidelity may not, without specific approval by the Board, exercise any deposit-taking or commercial landing powers not currently authorized by statute for a federal savings and loan association.

Branching Limitations

Finally, in order to prevent Citicorp from securing any competitive advantage with regard to geographic location over commercial banking organizations operating in California, the board's approval is conditioned upon applicant not establishing branches of Fidelity at locations not permissile for national or state banks located in California.

In order to prevent any unfair competitive advantage that might result from Fidelity's ability to establish remote service units in other states, the board also conditions approval upon applicant not establishing or operating a remote service unit at any location outside of California. The board believes that these restrictions are consistent with Citicorp's statements to the board that Citicorp intends to operate Fidelity as a savings and loan association in California and does not intend to use Fielity to achieve interstate branching or interstate acquisitions or to attract deposits from Citicorp's New York customers or from anywhere else in the country outside of California.

As noted in the order, to further ensure that Fidelity is operated as a savings and loan association and not utilized to further or enhance the activities of any Citicorp subsidiary, the board has imposed the conditions that require Fidelity to be operated as a separate, independent, profit-oriented corporate entity and has prohibited Fidelity from be operated in tandem with any other subsidiary of Citicorp.

(The board has previously indicated that serious adverse effects, including the potential for conflicts of interest, unfair competition and evasion of federal interest-rate limitations, may result from the tandem operation of a bank and a thirft association. First Financial Group of New Hampshire Inc., 66 Federal Reserve Bulletin 594 (1980), Heritage Banks Inc., 66 Federal Reserve Bulletin 590 (1980).)

Prohibit Certain Transactions

The board has also prohibited certain transactions between Fidelity and Citicorp or any of its subsidiaries without the board's prior approval. While the board has prohibited Citicorp from changing Fidelity's name to include the word "bank" or an other form that might confuse the public regarding Fidelity's status as a nonbank thrift institution, the Board does not regard as unfair competition applicant's use of the "Citi" prefix or the name "Citicorp" in Fidelity's name.

The board believes these conditions also address the concerns raised by several of the protestants regarding the potential for diversion of Fidelity's funds by Citicorp.

The potential adverse effects that might result from shifting assets and liabilities between Fidelity and Citicorp's other subsidiaries to take advantage of differing interest rates and costs is further protected against through the restrictions on interaffiliate transactions imposed by the Federal Reserve Act.

(Fidelity is subject to interest rate ceilings under 12 C.F.R. Part 526.)

Financial Support

The board has also considered the contention that Citicorp's financial support for Fidelity will give Fidelity an unfair competitive advantage over its thrift competitors.

In the board's opinion, the restoration of Fidelity as a viable competitor and the increased competition and improved and expanded services that are expected of Fidelity through access to the financial and managerial resources of Citicorp may only be viewed as a public benefit. (The fact that Citicorp will receive assistance from the FSLIC also will not result in unfair competition. According to the FSLIC, the Citicorp proposal in fact entails less financial assistance than the proposal of any other bidder. However, even if this were not the case, the FSLIC assistance merely remedies the severe competitive disadvantage now affecting Fidelity as a result of its weak financial condition.)

The fact that a particular depository institution is owned by an organization that is able to provide it with financial and managerial assistance may provide the institution with a competitive advantage, but there is nothing unfair about such an advantage. (The board also notes that a number of other thrift institutions in California are owned by parent organizations that are able to provide their subsidiaries with substantial financial support.)

Indeed, one of the principal concerns of the board under the BHC Act is that a bank holding company should serve as a source of financial strength and support for its subsidiaries.

Finally, the restrictions imposed in this order that Fidelity be operated as a separate, profit-oriented savings and loan association will also protect against unfair competition by Fidelity through its affiliation with Citicorp.

Case-by-Case Approach

The board also has considered the contention that the board's limitation of thrift acquisitions by bank holding companies to situations involving a failing institution and its case-by-case approach to such situations creates an unfair competitive situation. (The board notes that none of the protestants stated that it had been prevented from submitting an offer to acquire Fidelity were afforded a second opportunity to meet or exceed the Citicorp bid. In any event, the federal deposit insurance agencies have traditionally limited the group of institutions from which bids are solicited to ensure an orderly and prompt resolution of an emergency situations and this matter is appropriately reserved to the discretion of these agencies.) The board's approach to the question of thrift acquisition by bank holding companies is mandated by the BBC Act.

Where the board finds adverse a facts associated with a bank holding company proposal, the board is precluded from approving the proposal in the absence of counter-vailing public benefits. Because of the adverse effects associated with the affiliation of banks and thrifts that were identified by the board in "Baldwin," the board may only approve such an application where public benefits are present on the facts in a particular case that outweigh adverse effects. Such compelling public benefits have only been found where the thrift institution is failing.

Undue Concentration of Resources

The board has considered whether the proposal will result in an undue concentration of resources. Citicorp is the second largest banking organization in the country on the basis of total assets. Citicorp controls about 1.29% of domestic deposits in commercial banks, and savings and loan associations in the United States. On this basis, Citicorp is the third largest financial institution in the United States. Upon consummation, Citicorp would control approximately 1.37% of deposits in such institutions and would remain the third largest institution on this basis. The acquisition would increases Citicorp's total assets by 2.5%. Fidelity is the 42nd largest savings and loan association in the United States, and is not viewed by the Board as a predominant firm in its industry or in any geographic market. On the basis or __ facts and in view of Fidelity's financial condition, the board concludes that consummation of the proposal will not result in an undue concentration of resources.

The board concludes that concludes at consummation of the proposal, subject to the conditions set out in this order, may not reasonably by expected a result in conflicts of interest, unsound banking practices, or other adverse effects.

In reaching the conclusion that consummation of the proposal would not have a substantial impact on Citicorp's overall financial positions and the Citicorp has both the financial and managerial resources needed to acquire Fidelity and make it a viable competitor without any significant adverse effects on Citicorp, the board has considered the comments of the IBAA, the U.S. League, and others regarding Citicorp's foreign loan portfolio.)

Reasonably Expected Public Benefits

The board has also examined the record to determine whether consummation of the proposal may reasonably be expected to produce public benefits. The board believes that Citicorp's acquisition of Fidelity will provide a substantial and compelling public benefit in that Citicorp will provide Fidelity with sufficient new capital funds and managerial assistance to restore Fidelity as a viable competitor and to restore public confidence in Fidelity. Fidelity is a substantial organization, serving thousands of customers in numerous communities. In the board's opinion, the public benefits generally associated with revitalization of a failing financial institution are magnified in this case in view Fidelity's size and the number of its customers.

Restore Active Competitor

The record establihes that Citicorp has the financial and managerial resources and the commitment to serving the convenience and needs of the public to achieve this result. The acquisition will restore an active and effective competitor to, and increase competition in, numerous California markets, presents the potential for expansion and increased competition in other California markets, ensures the continuation of services by Fidelity to its customers and the public and protects the interest of Fidelity's depositors, the public, the savings and loan industry generally, and the FSLIC.

(In this connection, the U.S. Department of Justice stated that the acquisiton of thrift institutions by bank holding companies is procompetitive and will provide enhanced services at competitive prices, similarly, the Comptroller of the Currency urged approval of the proposed acquisition on the basis that it would be procompetitive and would provide significant public benefits.)

(The comptroller also expressed the view that the cost savings to the FSLIC would be a public benefit to other FSLIC-insured institutions and their depositors in view of the potentially large liabilities of the FSLIC as a result of the financial condition of the thrift industry. The Federal Deposit Insurance Corp. took no position on this particular application but stated its belief that the board has discretion under the BHC Act to approve the acquisition by a bank holding company of a thrift and that such an acquisition would provide an additional alternative for resolving situations involving financially troubled financial institutions and would be in the public interest.)

The board has considered as a substantial public benefit the savings to the FSLIC that will result from the proposal. The FHLBB has advised the board that the Citicorp bid was \$143 million more favorable to FSLIC than any other bid received and \$303 million less than the cost of maintaining a phoenix association. The FHLBB has also advised the board that, using an optimistic projection of interest rates, Citicorp's bid was \$56 million more favorable than the next lowest second round bid and \$35 million less than the cost of maintaining a phoenix association.

Citicorp's commitment to the introduction of new products and services and the expansion of current services and the expansion of current services of Fidelity through access to Citicorp's financial and managerial resources also lends weight toward approval.

Substantial Public Benefits

In addition to the substantial public benefits associated with the revitalization of Fidelity that have already been cited, Citcorp has stated that it intends not only to restore Fidelity as a competitor but to enhance its competitive position and to promote its services to the public by providing Fidelity with access to resources for the expansion of services in the areas of NOW accounts, consumer loans, credit cards, education loans, trust activities, and automated teller facilities.

This expansion of Fidelity's services and operations also will provide greater convenience to the public. Citicorp's experience and expertise, particularly in managing large scale operations and in the design and implementation of electronic banking and financial data processing, also should provide gains efficiency at Fidelity.

Finally, Citicorp has a good record of service to the convenience and needs of the public and has stated that it intends to use its resources to promote and expand Fidelity's service to its communities, including services directed to the credit needs of low- and moderate-income neighborhoods in those communities. (While the board does not believe that the Community Reinvestment Act is applicable in the case of section 4 applications, the board has considered Citicorp's record under that statute in acting upon this application.)

Community Consultation

In this connection, Citicorp representatives testified at the informal hearings that Fidelity would consult with community groups to determine the credit needs of the community and would study complaints with respect to Fidelity's lending and correct any deficiencies. The Board expects that Citicorp will adhere strictly to these commitments.

As stated above, protesters have asserted that Fidelity should not be regarded as failing institution because its con-

dition has stabilized as a result of the FSLIC receivership. According to protesters, this FSLIC assistance could continue for some time without significant deterioration in Fidelity's condition. Similarly, protesters state that declining interest rates have reduced funding costs for Fidelity and this also has served to relieve pressure on the institution.

The board concludes that any realistic assessment of Fidelity's condition compels the conclusion that Fidelity is a failing institution.

—— and Borrowings

It is undisputed that, on April 13, 1982, following a period of substantial deposit losses and substantial borrowings from the Federal Home Loan Bank of San Francisco of approximately $1.4 illion to maintain liquidity, the California Savings and Loan Commissioner closed Fidelity's predecessor and appointed the FSLIC as receiver for the state on the basis that Fidelity's predecessor was in an unsafe condition and conducting its business in an unsafe and injurious manner.

Substantial operating losses have continued at Fidelity since the receivership was announced and Fidelity's approximately $2.9 billion in assets is now supported by loans from the Home Loan Bank of over $1.7 billion. Deposit withdrawals at Fidelity have also been steady and substantial since appointment of the FSLIC as receiver and have forced the FSLIC to guarantee an advance of an additional $325 million to Fidelity from the Home Loan Bank since April 13.

The FHLBB has provided the Board —h data indicating that deposit outflows at Fidelity have increased during the first 21 days of September. The FHLBB has also advised that Fidelity's operating losses continue substantially unabated and that Fidelity has exhausted its net worth.

Much of the market value of a depository institution such as Fidelity is derived from its deposit base. More than 20% of Fidelity's deposit base has been dissipated since March 31, and thus, the assets held by the FSLIC as receiver must be regarded as wasting.

In addition, advances from the Home Loan Bank have grown to the point that they exceed Fidelity's deposits by a considerable margin. The FHLBB has informed the board that these advances now represent by far the greatest ratio

of advances to savings of any federally insured thrift institution.

The lack of public confidence in Fidelity even after the creation of the FSLIC receivership supports, in the board's view, the statement of the FHLBB that there is no evidence that the rate of decline in Fidelity's revitalization and rebuild public confidence in Fidelity. (Such an acqusition is also necessary to prevent the loss of employees that Fidelity is experiencing. The current receivership cannot provide the stability needed to retain key employees. Delay in resolving Fidelity's problems would mean that even greater efforts would be required to rebuild both employee morale and public confidence.)

In this regard, the FHLBB has advised the board that Fidelity's acquisition by Citicorp would make Fidelity viable again and remove any future risk that extraordinary assistance by the FSLIC would be needed.

Action to Minimize FSLIC Loss

For these reasons, the board concludes that Fidelity's continuing and unresolved financial problems require prompt action to minimize the loss to the FSLIC and provide Fidelity with a strong parent organization capable of restoring public confidence in that institution.

In the board's judgment and in light of the commitments made by Citicorp and the conditions imposed in this order, the public benefits expected from the restoration of public confidence in Fidelity and in the savings and loan industry, the substantial savings to the FSLIC, and reasonably expected gains in efficiency, increased competition and greater convenience to the public, outweigh any adverse effects that are associated with this proposal.

FSLIC Bid Procedures

Protesters have also asserted that, contrary to the determination by the FSLIC, Citicorp's bid to acquire Fidelity would not in fact result in the lowest cost to the FSLIC and that the FSLIC erred in not accepting a bid from one of the savings and loan associations that bid for Fidelity. The board does not believe that this is a proper issue for resolution by the board under section 4(c)(8) of the BHC Act. (The board

has considered the contention that the FSLIC is not authorized to sell the assets held by Fidelity because of litigation pending regarding the appointment by the FHLBB of the FSLIC as federal receiver. Fidelity Savings and Loan Association v. FHLBB, et al., No. 82-4337 and 82-4354 (N.D. Calif.). The board notes that the appointment of the FSLIC as receiver has not been stayed or otherwise enjoined and its appointment as receiver is, therefore, valid at this time. Nor has the court enjoined the FSLIC from transferring Fidelity to Citicorp.)

Section 4(c)(8) of the BHC Act does not require a determination that a given proposal is the most desirable that could be presented. Rather, the statute directs the board to determine whether reasonably expected public benefits from any given proposal outweigh possible adverse effects. The fact that alternative purchasers may be available is not determinative.

Even if the board were to conclude that another bid should have been accepted by the FSLIC, this decision would have little meaning because the board has no authority to award the right to acquire Fidelity to another bidder.

The decision as to which bid to accept is committed to the exclusive discretion of the FSLIC. An orderly administrative process dictates that the board substitute its judgment for that of the FSLIC. The board does, however, note that the procedures followed by the FSLIC generally complied with the procedures now under consideration by Congress for acquisition of failing federally insured thrift institutions and that FSLIC's decision to allow a second round of bidding for Fidelity in order to provide California financial organizations with an opportunity to match the bid of Citicorp adhered to the spirit of these proposals. The FSLIC also published the procedures it followed to the second round bidding in the Federal Register (47 Fed. Reg. 31322 (1982)).

Alternatives to Citicorp Proposal

A number of the protesters argued that the board's authority to approve a failing thrift acquisition under the BHC Act is limited to the situation presented in the Interstate case, where the Bard found that one of the factors in favor of

approval was the fact that the bank holding company's proposed acquisition was the only available means by which the thrift institution could be maintained as a competitor and prevented from being liquidated.

The fact that the proposed bank holding company acquisition of the thrift association in Interstate was the only available means of dealing with its condition was only one of the considerations that the board took into account in approving the Interstate application. There is no legal requirement under the BHC Act that there be no other viable alternative to a bank holding company acquisition of a failing thrift, and there is no indication in its Interstate decision that the Board intended that this factor must be present in every bank holding company application to acquire a failing thrift. (The approval of the primary regulatory authority for an acquisition of a failing thrift association is also not requirement under section 4(c)(8) of the BHC Act. In any event, in this case, the primary regulatory, the FHLBB, has urged board approval of the application as a means of restoring Fidelity to a stable condition.)

As was the case in Interstate, the primary regulator for Fidelity has explored all of the alternatives and has determined that the Citicorp proposal is substantially more favorable to Fidelity, its depositors and creditors and the FSLIC than any other bid and substantially reduces the insurance liability and risk to the FSLIC, including the potential cost, as compared to any other bid. The presence or absence of alternatives is but one factor in the evaluation of public benefits. As indicated, the board's responsibility under the BHC Act is to balance public benefits against possible adverse effects. In this case, the board believes that the balance of public benefits is favorable and that the application may be approved.

Several of protesters (including the IBAA, the U.S. League, the California ___ers, Crocker National Bank, Fidelity Federal Savings and Loan Association, Glendale, Calif., the California supervisory authorities, and Option Advisory Services Inc.) have requested the board to hold a formal hearing regarding Citicorp's proposal. They raise as the basis for a hearing the following:

(1) discovering is necessary so that all relevant facts associated with the application, including the complete record of the FSLIC's consideration of rious bids, may be provided to protesters;

(2) the need to "probe" or "examine" whether Citicorp has the fnancial resources to operate Fidelity in light of current international economic conditions;

(3) the need to assess the policy plications of Citicorp's application had the competitive effects of the proposal on banks and thrifts in California and the nation;

(4) whether Fidelity is or will be operated as a bank and whether its acquisition violates section 3(d) of the BHC Act;

(5) whether Citicorp's bid was more favorable than any other bid; and

(6) whether Fidelity's financial condition is so serious as to warrant Board approval of this application.

Both the board's rules of procedure and the Federal Register notice regarding this application state that any request for a formal hearing must indicate why a written proceeding would not suffice in lieu of a formal hearing and identify the disputed issues of fact that would be resolved at the formal hearing.

The persons requesting a hearing did not comply with this procedure. Rather, the hearing requests were conclusory in nature, did not delineate specific disputed facts, and were based on issues derived from the conclusions to be drawn from undisputed facts.

Apart from the fact that the protesters did not comply with the board's regulations and its notice, the protesters also failed to raise any factual issues that would warrant a hearing. With respect to the FSLIC bid procedures, the board believes that the issue of which bid was the more favorable and the fairness of FSLIC's procedures are not relevant to this proceeding and, thus, a hearing on these issues is not warranted.

Fidelity's Status

The question raised concerning Fidelity's status under the BHC Act involves an issue of law that also does not require a hearing. There is no dispute that Fidelity offers NOW ac-

counts and makes commercial real estate loans in accordance with the provisions of the HOLA.

Assessment of the quality of Citicorp's or Citibank's loan portfolio and Citicorp's financial ability to operate Fidelity is a responsibility that is vested in the federal bank regulatory agencies, and public participation in this process would be inconsistent with the entire scheme of federal bank regulation.

The board's assessment under the BHC Act of Citicorp's financial resources, including its overseas loan portfolio, is based upon detailed examination of the operations of Citicorp's subsidiaries. Protesters have alleged no dispute as to the facts regarding Citicorp's financial resources or its foreign loans, but rather have merely advanced conjectural and conclusory statements to support their hearing request on this point.

Indeed, the hearing requests are framed in terms of a need to probe or examine rather than on any specific or supported allegation of financial weakness.

In the board's opinion, protesters' questions regarding Citicorp's financial resources and the conclusions to be drawn therefrom do not require a formal hearing. Protesters were afforded ample opportunity to present their testimony on these points and to question Citicorp. To warrant a hearing, the board believes that protesters must raise more than generalized claims and requests to "probe" an applicant's financial resources.

In the board's opinion, the hearing requirement in the BHC Act, as it has been interpreted by the courts, does not require the Board to hold a hearing on the basis of conjecture or unsupported allegations and the board is not required "to investigate every potential adverse contingency which a contestant hypothesizes."

Unfair Competition Concern

The essential element of protesters claim of unfair competition is a request that the board evaluate the competitive impact of the proposal based on the allegation that Citicorp would be an effective and aggressive competitor with advantages not available to its banking and thrift competitors. As

explained above, the board believes it has addressed these concerns through the imposition of appropriate conditions that eliminate the unfair competitive advantage that the protestants claim may result, and in any event material facts are not in issue regarding the allegation of unfair competition.

The board believes that the procedures it used to solicit and explore the various policy and legislative-type concerns raised by protestants were appropriate under the circumstances and fully adequate under the BHC Act. The board imposed no limitation on the length or nature of the written comments.

In addition, the board held informal hearings in Washington, D.C., and San Francisco, Calif. that were attended by a total of approximately 200 people. All persons that wished to speak at these hearings were given an opportunity to do so, and all persons that spoke at the informal hearings were given an opportunity to submit questions to Citicorp regarding the application. A member of such questions were received and Citicorp responded to all of them.

In addition, the board has explored the policy issues raised by protesters on a number of occasions over the last ten years, including in a rulemaking proceeding and oral presentation to the board. Last year, the board's staff completed a detailed study of the implications of thrift acquisitions by bank holding companies. The board solicited public comment on the general issue of such acquisitions in conjunction with this study and reviewed some 379 written comments on that study.

No Formal Hearing Needed

Based on the foregoing considerations, the board does not believe that a formal hearing is required or appropriate in this case and denies the requests of the protestants for a formal hearing.

(The board provided 21-days notice in the Federal Register of receipt of Citicorp's application to acquire Fidelity. Since the Federal Register Act states that a statutory requirement of notice and opportunity for hearing is satisfied by a notice period of fifteen days (44 U.S.C. § 1508), the

board believes that the notice period in this case is legally sufficient. The board also believes that the twenty-one day comment period is appropriate in view of the request of the FHLBB that the board act expeditiously and the fact the board also held two informal hearings at which interested persons could provide comments on the application and question Citicorp concerning the proposal. The board believes that interested persons have been afforded ample opportunity under the circumstances to submit their views on the proposal.)

Request for a Stay of the Order

Several protesters, including the IBAA, have requested that, in the event the board approves the proposed acquisition, the board stay the effectiveness of the approval pending judicial review of the board's action. The board has reviewed these requests in light of the factors generally applied by the courts on stay requests and, based upon that review, does not believe that a stay of the board's order in this case is appropriate.

First, as explained in detail above, the board believes that its approval of Citicorp's acquisition of Fidelity, subject to the conditions imposed in the order, complies with all applicable procedural and substantive requirements and is supported by substantial evidence. Accordingly, it is unlikely, in the board's opinion, that any protesters will be successful in overturning the board's approval on judicial review.

Second, the board has expressly found that Citicorp's acquisition of Fidelity is not likely, under the conditions imposed by the board, to result in any significant unfair competitive advantage, or other competitive harm to depository institutions that compete with Fidelity or Citicorp, or to their depositors, or the public generally. Moreover, in this case, there is little likelihood that consummation of the acquisition would prevent a reversal of the transaction should such action subsequently become necessary since Fidelity will be maintained as a separate corporate entity. Thus, in the board's view, there is no likelihood of any irreparable harm to any protesters if a stay is not granted.

Third, the board has found that, in light of Fidelity's significant continuing daily net loss of deposits and its operating losses, a delay in consummation of this proposal would permit continued significant financial harm to Fidelity that would otherwise be remedied by consummation of the proposal. Moreover, delay would continue to encourage the departure of employees and to exacerbate the adverse publicity regarding Fidelity since its closing by supervisory authorities. Because of these facts, the board is concerned that it may be more difficult to restore Fidelity to a viable condition if a stay is granted.

The loss of Fidelity's important competitive presence would harm the customers for financial services in its market area. Citicorp would also be harmed by a stay pending review since delay would increase significantly the amount of funds Citicorp would be required to expend to revitalize Fidelity. Finally, during the pendency of any stay, the FSLIC, as receiver of Fidelity, may be required to extend funds to Fidelity to cover its continuing operating losses and to assure maintenance of some minimal net worth, funds that could be used to assist other financially troubled institutions.

The board finds, therefore, that the granting of stay would cause significant harm to third parties.

Finally, the board believes that a stay in this case is clearly not in the public interest. A stay would leave unresolved for a lengthy time the ultimate control and ownership of a failing thrift institution, would prevent the restoration of Fidelity as an active competitive force in its market area, and could result in substantial losses to the FSLIC.

For these reasons, the board hereby denies protesters' request for a stay of the board's order.

Conditions of Approval

The board's approval of this application is further subject to the conditions set forth in section 225.4(c) of Regulation Y and to the board's authority to require such modification or termination of the activities of a holding company or any of its subsidiaries as the board finds necessary to assure compliance with the provisions and purposes of the BHC Act and

the board's regulation and orders issued thereunder, or to prevent evasion thereof.

The transaction shall be made not later than three months after the effective date of this order, unless that period is extended for good cause by the board or by the Federal Reserve Bank of New York acting pursuant to authority hereby delegated.

By order of the board of governors, effective Sept. 28, 1982. (Voting for this action: Chairman Volcker and governors Martin, Partee, Teeters, Rice, and Gramley. Absent and not voting: governor Wallich.)

James McAfee
Associate Secretary of the Board

EDITOR'S NOTE

THE FOLLOWING PAGES WERE POOR HARD COPY AT THE TIME OF FILMING. IF AND WHEN A BETTER COPY CAN BE OBTAINED, A NEW FICHE WILL BE ISSUED.

Interstate Banking: Taking Inventory

U.S. banking organizations now control over 7,000 interstate offices. Even if present prohibitions are lifted, however, the evidence suggests that interstate bank expansion will evolve slowly and will be limited to the more attractive markets.

Although interstate banking is prohibited by the McFadden Act and the Douglas amendment to the Bank Holding Company Act, the fact is that banking organizations are providing financial services across state lines and have been doing so for some time. Four gateways allow commercial banking organizations to offer financial services on an interstate basis. First, "grandfather" provisions of banking legislation allow some banking organizations to maintain full-service commercial banks in more than one state. Second, the Garn-St Germain Depository Institutions Act of 1982 allows banks and savings and loan associations to acquire failing institutions across state lines. Third, and perhaps more importantly, the 4(c)8 provisions of the Bank Holding Company Act allow bank holding companies to establish or acquire nonbank subsidiaries that are not subject to the prohibitions on interstate banking. And fourth, other nonbank subsidiaries may establish offices across state lines, i.e. loan production offices and Edge Act corporations, allowing their parent organization to provide financial services on an interstate basis.

In addition, the BHC Act allows bank holding companies to acquire or establish banking subsidiaries in states which explicitly permit such entry. This article will describe various ways in which bank holding companies provide interstate financial services and will inventory their activities on a state-by-state basis. This should give us some idea of the extent to which bank holding companies are actively supplying interstate financial services. The numbers presented in this inventory represent the best available information but may not include all activities or offices. Therefore, the figures represent activities and offices documented by our inventory and should be viewed as a minimum.

Grandfathered Interstate Banking

Legislation and regulation tend to follow actual events in the marketplace. This is especially

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Table 1. Foreign and Domestic Bank Holding Companies With Subsidiary Banks In More Than One State

Bank Holding Company	Home State	Number of States	States In Which Banks Are Located
First Interstate Bancorporation	CA	11	AZ, CA, CO, ID, MT, NM, OR, NV, WA WY, UT
First Bank System, Inc	MN	5	MN, MT, ND, SD, WI
Northwest Bancorporation	MN	7	IA, MN, MT, NE, ND, SD, WI
Otto Bremer Foundation	MN	3	MN, ND, WI
Financial General Bancshares, Inc	DC	5	DC, MD, NY, TN, VA
General Bancshares Corporation	MO	3	IL, MO TN
First Security Corporation	UT	3	ID, WY, UT
Citicorp	NY	3	DE, NY, SD
Bank of Montreal*	NY	2	CA, NY
Canadian Imperial Bank of Commerce*	NY	2	CA, NY
The Bank of Tokyo, Ltd*	CA	2	CA, NY
Barclays Bank Limited*	NY	2	CA, NY
The Sumitomo Bank, ltd.*	CA	2	CA, HI
The Royal Bank of Canada*	NY	2	NY, PR
Banco Central, S.A.*	NY	2	NY, PR
J.P. Morgan & Company	NY	2	DE, NY
The Girard Company	PA	2	DE, PA
NCNB Corporation	NC	2	FL, NC
Chase Manhattan Corporation	NY	2	DE, NY
Provident National Corporation	PA	2	DE, PA
Northern Trust Corporation	IL	2	FL, IL
Maryland National Corporation	MD	2	DE, MD
Philadelphia National Corporation	PA	2	DE, PA
First Maryland Bancorp	MD	2	DE, MD
Equitable Bancorporation	MD	2	DE, MD
Chemical New York Corporation	NY	2	DE, NY
Manufacturers Hanover Corporation	NY	2	DE, NY
Pittsburg National Corporation	PA	2	DE, PA

Source: Federal Reserve Board as of 12/31/82
*Foreign banking organizations

true in banking. Market participants first become creative in terms of supplying financial services, and then legislators and regulators react to the evolving market circumstance. Reacting to changing market conditions means that legislators are constantly faced with restricting given activities after innovative organizations have engaged in the activity. In some cases it would be detrimental or impossible to require the organization to cease the activity even though a general prohibition is deemed desirable. In such cases, one equitable approach is to allow the innovative organization to continue but not expand the activity in question. Such a clause is then written into the legislation and is termed a "grandfather provision." A number of domestic and international banking organizations enjoy such grandfather provisions with respect to prohibitions on interstate banking.

We were able to identify 21 domestic bank holding companies that controlled banking subsidiaries in more than one state. One of these organizations controlled banking subsidiaries in 11 states, one had banking subsidiaries in seven states, two had subs in five states, four had banking subsidiaries in three states and the remainder were represented in only two states (Table 1). In total these 21 banking organizations control 138 banks and 1,369 branch offices in 22 states. This means that almost half of our states house banks controlled by out-of-state holding companies.

In addition to domestic holding companies controlling interstate banks, seven international

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Table 2. Foreign Banking Organizations Controlling Interstate Offices

State	Number of Foreign Banking Organizations Controlling Interstate Offices by State of Residence	Number and Type of Interstate Office Locations by Type of Office: Banks	Branches	Edge Acts	Agencies	Total Number of Interstate Offices Controlled by Foreign Banking Organizations Headquartered Outside the State
California	26	8	2	2	63	75
District of Columbia	—	—	1	—	—	1
Florida	1	—	—	6	22	28
Georgia	—	—	—	—	10	10
Hawaii	—	1	—	—	2	3
Illinois	1	1	36	3	—	40
Louisiana	—	—	—	—	1	1
Massachusetts	1	—	4	—	—	4
New York	58	3	37	2	18	60
Oregon	—	—	7	—	—	7
Pennsylvania	—	—	6	—	—	6
Texas	—	—	—	9	—	9
Washington	—	—	10	—	—	10
	103*	13	103	22	116	254

*16 of these organizations that have offices in more than one state are international organizations having no resident state—i.e. agency offices of international banks.

Source: Federal Reserve Bank of New York, as of 6-30-82.

banking organizations control banks in more than a single state. Table 1 identifies and locates these organizations. Prior to the Bank Holding Company Act of 1956, international organizations could establish banks in more than one state. Following 1956, however, any international organization controlling more than one U.S. bank fell under the Holding Company Act and became subject to the Douglas Amendment. Grandfather provisions allowed these organizations to continue their interstate system but restricted the organization from expanding outside its declared home state. In total, seven international bank holding companies control seven banks in states other than the state in which they are based. Of the seven foreign holding companies controlling banks in more than one state, five declared New York as their state of residence and two declared California (Table 2).

Fifty-three international banks have interstate branches, 25 of which are home officed in New York and 24 in California. As Table 2 shows, 71 percent of their interstate branches (73 in number) are located in either New York or Illinois. As would be expected, most of the interstate branches of foreign banks are located in our larger cities and trade centers. These organizations then have established an interstate presence of full service banks in some of our most attractive markets.

In addition to the 103 interstate branches established by foreign banks, they have established 116 interstate agency offices and 22 interstate Edge Act offices. This brings the total number of interstate offices of foreign banks and holding companies to 254 (Table 2).

The door to interstate banking is not completely closed. The Douglas Amendment allows bank holding companies to acquire banks on an interstate basis if the target state passes legislation that specifically allows out-of-state holding companies to acquire instate banks. To date, five states have passed such legislation.[1] Two other

[1] Utah passed reciprocal legislation in 1981 but repealed same in 1983.

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Table 3. Interstate Savings and Loan Associations and Their Geographic Coverage
(March 7, 1983)

Parent	Home Office Locations	Interstate Locations
1. Northeast Savings, F.A.	CT	CT, MA, NY
2. City FS & LN	NJ	NJ, FL
3. Empire of America, FSA	MI	MI, FL, NY, TX
4. Carteret S&LA, FA	NJ	NJ, FL
5. Perpetual American FS&LA	VA	VA, DC, MD
6. Home Savings of America, FS & Los Angeles	CA	CA, FL, IL MO, TX
7. Glendale FS&LA	CA	CA, FL
8. First Nationwide Savings FS & LA	CA	CA, NY, FL
9. California FS & LA	CA	CA, GA, FL, NV
10. World S&LA, A FS&LA	CA	CA, KS, CO
11. First FS&LA of Arizona	AZ	AZ, TX
12. Bay Savings Bank	MI	MI, VA
13. National Permanent FS&LA	DC	DC, MD
14. First FS&LA of Puerto Rico	PR	PR, VI
15. Charter FS&LA	GA	GA, AL
16. Equitable FS&LA	MD	MD, DC
17. Union FS&LA of Evansville	IN	IN, KY
18. Farm and Home SA	MO	MO, TX
19. Mountainwest S&L	UT	UT, WY
20. The Benj Franklin FS&LA	OR	OR, ID, WA, UT

Source: Federal Home Loan Bank Board

states, Delaware and South Dakota, allow entry through limited purpose banks, and both have actually experienced entry by out-of-state holding companies. In addition, Iowa, Illinois, and Florida allow expansion by out-of-state banking organizations that operate banks or trust companies under grandfather provisions.

Although interstate deposit-taking is prohibited, many interstate banking services exist, and more could develop in the future even without changes in the federal laws prohibiting interstate banking. Three recent avenues for establishing an interstate banking presence or position are through the purchase of up to 5 percent of voting stock, preferred convertible stock,and franchise agreements among banks.

The Bank Holding Company Act specifies that it "shall be unlawful, except with the prior approval of the Board, . . . for any bank holding company to acquire directly or indirectly ownership or control of any voting shares of any bank, if after such acquisition, such company will directly or indirectly own or control more than 5 percent of the voting shares of such bank. . . ."[2] This clause leaves the door open for bank holding companies to acquire up to 5 percent of the voting shares of a bank without Board approval. As a result, some bank holding companies have taken the opportunity to invest in banks across state lines, establishing associations of banks that may work together for their common benefit. These investments have taken the form of 4.9 percent voting stock ownership, nonvoting preferred stock that automatically converts to voting stock should the prohibition on interstate banking be removed, or simple franchise agreement among banks.

Whatever the path, the result is a potential interstate network of banks large enough and geographically dispersed enough to offer products and services no one bank may have been capable of offering separately. These formal and informal agreements represent a form of geographic

[2]Section 3(a) Bank Holding Company Act of 1956.

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positioning for the day when interstate powers are granted. Texas Commerce Bankshares, for example, has investments in banks in Wyoming, Colorado, Arizona, Oklahoma and Louisiana.[3] While no comprehensive list of these investments and agreements was available, we are aware of these methods to establish an interstate presence. To date the Federal Reserve Board has approved two preferred stock deals, has disapproved one which is being restructured and has at least seven others pending.

The Bank Holding Company Act does not prohibit individuals from acquiring more than one bank. Neither does it require individuals to file an application with the Board regarding the acquisition of bank stock either within a given state or on an interstate basis.[4] We know that interstate banking groups controlled by individuals exist, but we have no accurate measure of the number of these groups or the number and geographic dispersion of the banks involved. To this extent, our inventory again is understated.

Another avenue for interstate expansion was opened by the emergency provisions of the Depository Institutions Act of 1982 allowing out-of-state organizations to acquire troubled banks and insured mutual savings banks under certain circumstances.[5] Although these provisions have not been used to allow interstate bank acquisitions to date, they do provide an avenue for interstate expansion.[6] The Federal Home Loan Bank Board began allowing interstate mergers of savings and loans in 1981, allowing only four that year. In 1982, however, 16 such mergers were allowed and today 29 interstate savings and loan systems exist (Table 3). Although these cases are limited, the provisions of the Garn-St Germain Depository Institutions Act and the fact that the Federal Home Loan Bank Board is actively allowing S&Ls to merge across state lines indicates increasing pressure for further relaxation of the prohibition on interstate banking.

Commercial banks are the only financial services suppliers effectively constrained geographically today, and even these constraints do

Map 1
Resident State of Bank Holding Companies Controlling Interstate 4(c)8 Subsidiaries

Total: 139

not apply to all commercial banks under all conditions. The fact that a commercial banking organization in one state may acquire a failing institution in another state inevitably will result in commercial banks facing competition from interstate banking organizations.[7] Because of the criteria for such acquisitions, the degree of competition may be limited at first; yet as the failing institution recovers and takes advantage of its association with an interstate parent, local bank competitors will resent such relationships. Geographically constrained banking organizations will feel that a two way competitive street is necessary. As the number of such acquisitions across state lines increases, support for repeal of interstate bank prohibitions will also increase. The emergency provisions of the Depository

[3] United States Banker, January 1983, p. 15.
[4] See "Change in Bank Control Act," Title VI of the Financial Institutions Regulatory and Interest Rate Control Act of 1978.
[5] See footnote 1.
[6] The Depository Institution Act of 1982 allows closed insured commercial banks with assets of $500 million or more and insured mutual savings banks with assets of $500 million or more and in danger of failing to be acquired by an out-of-state bank or bank holding company with priority given in the following order: acquisition of similar institutions in the same state; acquisition by same type of institution in different states; acquisition by different types of institutions in the same state; and acquisition by different types of institutions in different states.
[7] The degree of interstate expansion through the emergency provisions will be limited by the requirement that the failing institution must have at least $500 million in assets. It may be possible, however, for a number of weak institutions to be consolidated in order to meet this requirement. An organization in Tennessee is currently attempting such a consolidation.
[8] Section 2(c) of the Bank Holding Company Act of 1956.

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Institutions Act of 1982 may in fact be unlocking the door to full interstate banking.

Given the number of interstate banking organizations, the extent of their geographic coverage, the other unmeasured forms of interstate banking, and the potential avenues for still further expansion, the actual extent of interstate banking is probably far greater than might be assumed given the laws prohibiting it.

Nonbank Subsidiaries

For purposes of the Bank Holding Company Act, a bank is defined as "... any institution ... which (1) accepts deposits that the depositor has a legal right to withdraw on demand, and (2) engages in the business of making commercial loans."[8] Therefore an organization that offers both demand deposits and commercial loans may be defined as a commercial bank, and, hence, would fall under the interstate banking restrictions. The laws prohibiting interstate banking limit the ability of a formal banking organization to offer both demand deposits and commercial loans at a single location in more than one state. But by separating the demand deposit and commercial lending functions it is possible for banking organizations to circumvent the interstate restrictions and provide interstate financial services. Indeed, nothing prevents a commercial bank in one state from advertising and accepting demand deposits or savings deposits from consumers in another state. Many large commercial banks aggressively sell large certificate of deposits on an interstate basis. They employ calling officers to seek out major accounts nationwide, and they market their credit cards nationwide. In addition, commercial banks are offering such financial services as cash management, electronic funds transfer accounts, loan participations and a variety of correspondent banking services that know no state boundary. These are all examples of services offered across state lines that do not require the bank to establish a physical presence.

By separating the demand deposits and commercial lending functions, however, a banking organization can establish a physical presence across state lines. One way for bank holding companies to accomplish this is through the creation or acquisition of nonbank subsidiaries. The nonbank subsidiaries do not constitute a commercial bank and, hence, are free to open offices on an interstate basis. National banks may undertake a number of the same 4(c)8 type activities allowed to bank holding companies (Table 4). For the most part, however, these activities are constrained to the state in which the parent bank is located.

Identifying Interstate 4(c)8 Offices

With the assistance of the eleven other Federal Reserve District Banks, we were able to piece together a composite picture of holding companies throughout the nation that controlled interstate 4(c)8 subsidiaries and the number of interstate offices each controlled. Although an application is required prior to a 4(c)8 subsidiary opening a new office, no consolidated records were available. Each District Federal Reserve Bank compiled a list of holding companies with interstate 4(c)8 offices and provided the office locations on a state-by-state basis. In a few instances it was necessary to contact holding companies directly to obtain the desired information. This article presents the best information available on 4(c)8 interstate activity, but the data may not be 100 percent inclusive. The numbers represent an actual count of those institutions and office locations of those institutions we identified as being involved in 4(c)8 services on an interstate basis. Therefore, the numbers may understate the extent of interstate activity.

In total there are 3,201 one-bank holding companies and 430 multibank holding companies in the United States (Table 5). Of the 3,631 holding companies capable of establishing or acquiring interstate offices of 4(c)8 subsidiaries, only 139 or approximately four percent elected to do so. Of those 139, 68 were one-bank and 71 were multibank holding companies. One common characteristic of holding companies electing to go interstate through their 4(c)8 subsidiares was their absolute size. Of the 50 largest banking organizations in the country, 42 have interstate 4(c)8 subsidiaries. Of the 100 largest banking organizations, 70 have 4(c)8 subsidiaries that control interstate offices; of the top 150 organizations, 102 have interstate 4(c)8 subsidiaries. Therefore, as a generalization, large bank holding companies are the most likely to provide interstate financial services through offices of their 4(c)8 subsidiaries. They are also the organizations most likely to undertake interstate banking if or when the prohibitions are lifted.

Table 5 also indicates that these 139 holding companies control 382 4(c)8 subsidiaries which collectively have at least 5,500 offices outside

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Allowable Nonbank Activities

The Bank Holding Company Act of 1956 as amended in 1970 defines a bank holding company as[8]—any company which has control over any bank or over any company that is or becomes a bank holding company by virtue of this Act." The term company includes all legal entities except individuals—that is, corporations, partnerships, trusts or associations. Individuals are excluded and consequently may own any number of banks or other financial institutions in any number of states without coming under the provisions of the act. For purposes of the act, the term "control" was defined as controlling directly or indirectly 25 percent or more of any class of voting securities of the bank or company, or controlling the election of a majority of directors or trustees of the bank or company, or the Board of Governors of the Federal Reserve System determines that the company directly or indirectly exercises a controlling influence over the management or policies of the bank or company.[9] This latter provision gives the Board of Governors wide latitude in determining what constitutes control, and hence, what is or is not a holding company.

Section 4(c)8 of the Bank Holding Company Act states the criteria the Board must apply before allowing bank holding companies to engage in certain nonbank activities. Some of those nonbank activities are prohibited to individual banks, but the majority are activities in which nationally chartered banks may engage.[10] Under 4(c)8, a bank holding company may be exempted from the general prohibition against acquiring or establishing nonbank activities and allowed to acquire.

> "shares of any company the activity of which the Board after due notice and opportunity for hearing has determined (by order or regulation) **to be so closely related to banking or managing or controlling banks as to be a proper incident thereto.** In determining whether a particular activity is a proper incident to banking or managing or controlling banks the Board shall consider whether its performance by an affiliate of a holding company can reasonably be expected to produce benefits to the public, such as greater convenience, increased competition or gains in efficiency, that outweigh possible adverse effects, such as undue concentration of resources, decreased or unfair competition, conflicts of interest, or unsound banking practices."

To be considered a permissible nonbank activity for bank holding companies, the activity must pass two tests. First, it must be closely related to the activities in which banks engage. This is a rather vague criterion in light of the "incidental powers" accorded banks through Section 8 of the National Bank Act of 1864 which states that banks may "exercise... all such incidental powers as shall be necessary to carry on the business of banking...". Given this vagueness it is not surprising that the Board of Governors has no published statement of the criteria it uses to determine activities closely related to banking. Researchers have observed, however that the Board has approved activities in which banks have historically engaged, or activities complementing services normally provided by banks or activities in which banks clearly possess technical skills.[11] If the activity satisfies at least one of these criteria, it may be proclaimed a permissible activity if it also passes the second test: that providing the service through a nonbank subsidiary may reasonably be expected to produce net public benefits.

The Board may approve a nonbank activity either by order or by regulation—adding the activity to the "laundry list" of approved activites as set forth in Regulation Y, Section 4(c)8. If the activity is approved by order, then every future applicant wishing to undertake that activitiy must justify the activity to the Board. Effectively, this amounts to a case-by-case review and opinion. On the other hand, if the activity is approved and added to approved activities listed in the regulation, a future applicant need not justify the activity and an application may be approved under delegated authority at the Reserve Bank level if all other conditions for delegated authority are met.

To date, the Board has approved and added to the "laundry list" 17 activities in which bank holding companies may engage by either establishing *de novo* nonbank subsidiaries or acquiring nonbank subsidiaries. The approved activities are set forth in Table 4.

Through an application process, one bank and multibank holding companies may gain approval to establish a nonbank subsidiary to engage in any or a combination of activities. By definition, a nonbank subsidiary is not a bank and, hence, does not fall under regulations or laws that apply only to banks. The nonbank entities are, therefore, capable of unrestricted geographic expansion both intrastate and interstate.[12] Since the vast majority of the approved nonbank activities are activities in which banks may engage, i.e. "activities which are closely related to banking or managing or controlling banks...",the 4(c)8 provisions effectively allow bank holding companies to provide financial services similar to those provided by banks but on an interstate basis.

[8]See Statutory Appendix to Regulation Y.

[9]See Dale S. Drum, "Nonbanking Activities of Bank Holding Companies" Economic Perspective, Federal Reserve Bank of Chicago, March/April, 1977.

[10]See for example, Harvey Rosenblum, "Bank Holding Companies: An Overview" Business Conditions, Federal Reserve Bank of Chicago, August, 1973; or Samuel H. Talley: "Developments in the Bank Holding Company Movement", Proceedings of a Conference on Bank Structure and Competition, 1972, Federal Reserve Bank of Chicago.

[12]In two cases, bank holding companies have received approval to acquire troubled S&Ls with the condition that bank branching laws would apply to the acquired S&Ls.

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Table 4. Permissible Nonbank Activities for Bank Holding Companies Under Section 4(c)8 of Regulation Y
February, 1983

Activities permitted by regulation

1. Extensions of credit[2]
   Mortgage banking
   Finance companies: consumer, sales, and commercial
   Credit cards
   Factoring
2. Industrial bank, Morris Plan bank, industrial loan company
3. Servicing loans and other extensions of credit[2]
4. Trust company[2]
5. Investment or financial advising[2]
6. Full-payout leasing of personal or real property
7. Investments in community welfare projects[2]
8. Providing bookkeeping or data processing services[2]
9. Acting as insurance agent or broker primarily in connection with credit extensions[2]
10. Underwriting credit life, accident and health insurance
11. Providing courier services[2]
12. Management consulting for all depository institutions
13. Sale at retail of money orders with a face value of not more than $1000, travelers checks and savings bonds[1, 2]
14. Performing appraisals of real estate[1]
15. Issuance and sale of travelers checks[1]

Activities permitted by order

1. Issuance and sale of travelers checks[2, 6]
2. Buying and selling gold and silver bullion and silver coin[2, 4]
3. Issuing money orders and general-purpose variable denominated payment instruments[1, 2, 4]
4. Futures commission merchant to cover gold and silver bullion and coins[1, 2]
5. Underwriting cetain federal, state and municipal securities[1, 2]
6. Check verification[1, 2, 4]
7. Financial advice to consumers[1, 2]
8. Issuance of small denomination debt instruments[1]
9. Arranging for equity financing of real estate[1]
10. Acting as futures commissions merchant[1]
11. Discount brokerage[1]
12. Operating a distressed savings and loan association[1]
13. Operating an Article XII Investment Co.[1]
14. Executing foreign banking unsolicited purchases and sales of securities
15. Engaging in commercial banking activities abroad through a limited purpose Delaware bank[1]
16. Performing appraisal of real estate and real estate advisor and real estate brokerage on nonresidential properties.[1]
17. Operating a Pool Reserve Plan for loss reserves of banks for loans to small businesses[1]
18. Operating a thrift institution in Rhode Island
19. Operating a guarantee savings bank in New Hampshire[1]
20. Offering informational advice and transactional services for foreign[1] exchange services

Activities denied by the Board

1. Insurance premium funding (combined sales of mutual funds and insurance)
2. Underwriting life insurance not related to credit extension
3. Sale of level-term credit life
4. Real estate brokerage (residential)
5. Armored car
6. Land development
7. Real estate syndication
8. General management consulting
9. Property management
10. Computer output microfilm services
11. Underwriting mortgage guaranty insurance[3]
12. Operating a savings and loan association[1, 5]
13. Operating a travel agency[1, 2]
14. Underwriting property and casualty insurance[1]
15. Underwriting home loan life mortgage insurance[1]
16. Investment note issue with transactional characteristics[1]
17. Real estate advisory services[1]

[1]Added to list since January 1, 1975.
[2]Activities permissible to national banks.
[3]Board orders found these activities closely related to banking but denied proposed acquisitions as part of its "go slow" policy.
[4]To be decided on a case-by-case basis.
[5]Operating a thrift institution has been permitted by order in Rhode Island, Ohio, New Hampshire and California.
[6]Subsequently permitted by regulation.
Source: Federal Reserve Board

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Map 2
Number of Interstate Subsidiaries of Holding Companies Home Officed in the State

Total: 382

Map 3
Total Number of Offices: All 4(c)8 Subsidiaries

Total: 5,500

the state in which the parent holding company resides. Map 1 indicates that 56 of these holding companies (41 percent of the total) with interstate 4(c)8 subsidiaries reside in 10 northeastern states (Maine, New York, Massachusetts, Rhode Island, Connecticut, Pennsylvania, New Jersey, Delaware, Maryland and Virginia). The highest concentration of holding companies controlling 4(c)8 subsidiaries with interstate offices is in the northeastern portion of the nation.

Map 2 shows the number of 4(c)8 subsidiaries controlled by holding companies home officed in a given state. In total the 139 holding companies control 382 4(c)8 subsidiaries with interstate offices. Approximately fifty percent of the 4(c)8 subsidiaries (191) have parent holding companies that reside in the Northeast, specifically the northeastern coastal states from Virginia to Maine plus Pennsylvania (Maine, New York, Massachusetts, Rhode Island, Connecticut, Pennsylvania, New Jersey, Delaware, Maryland and Virginia). And as Map 3 shows, these 191 subsidiaries controlled better than 64 percent (3,472) of all interstate 4(c)8 offices. Therefore, the vast majority of holding companies controlling 4(c)8 subsidiaries with interstate offices are based in the Northeast. In fact, New York and Pennsylvania alone accounted for 22 percent (30) of all holding companies with interstate 4(c)8 subsidiaries. Holding companies in those two states controlled 124 separate interstate subsidiaries, 33 percent of the total, and 1,874 (34 percent) of the total interstate offices. This is not surprising given the number of large holding companies in this area. If interstate positioning through 4(c)8 subsidiaries is any indication, large organizations, especially those in the Northeast, are the most likely to become active in interstate banking if and when the laws permit.

Types of Financial Services Provided

A nonbank subsidiary may provide more than one 4(c)8 activity at a given location. For instance, a nonbank subsidiary primarily engaged in consumer finance activity may also provide credit life insurance and leasing activities. Therefore, there is a difference between the number of 4(c)8 services provided and the number of 4(c)8 subsidiaries and the number of offices of 4(c)8 subsidiaries. Table 6 summarizes the number of 4(c)8 activities provided through

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Table 5. Bank Holding Companies, Number with Interstate 4(c)8 Subsidiaries and Offices of Interstate 4(c)8 Subsidiaries by State

Home State of Holding Company	Total Number of Holding Companies Home Officed in State: One-Bank	Multi Bank	Total	Interstate Companies: Number of Holding Companies	Number of Subsidiaries	Number of Offices
Alabama	16	9	25	4	5	12
Alaska	3	1	4	—	—	—
Arizona	5	0	5	0	—	—
Arkansas	47	2	49	1	1	1
California	42	6	48	5	28	636
Colorado	104	22	126	1	1	1
Connecticut	7	3	10	2	5	13
D.C.	7	3	10	—	—	—
Delaware	12	1	13	1	3	1,171
Florida	48	29	77	3	4	50
Georgia	49	22	71	4	7	157
Hawaii	3	0	3	—	—	—
Idaho	6	1	7	1	1	2
Illinois	316	7	323	5	24	70
Indiana	66	1	67	3	11	38
Iowa	268	16	284	2	2	3
Kansas	323	8	331	2	2	2
Kentucky	43	1	44	1	1	5
Louisiana	47	1	48	—	—	—
Maine	2	4	6	1	1	1
Maryland	3	4	7	6	18	102
Massachusetts	14	13	27	4	10	34
Michigan	18	24	42	1	3	6
Minnesota	286	15	301	3	21	585
Mississippi	26	0	26	1	1	2
Missouri	175	40	215	7	7	7
Montana	34	7	41	—	—	—
Nebraska	283	0	283	2	2	2
Nevada	2	0	2	—	—	—
New Hampshire	6	4	10	—	—	—
New Jersey	8	11	19	4	7	17
New Mexico	19	4	23	—	—	—
New York	19	11	30	19	96	1,593
North Carolina	9	1	10	4	9	226
North Dakota	51	4	55	—	—	—
Oklahoma	250	6	256	1	1	1
Ohio	16	17	33	11	12	12
Oregon	3	5	8	2	8	27
Pennsylvania	32	3	35	11	28	283
Rhode Island	11	0	11	3	16	167
South Carolina	5	0	5	3	7	86
South Dakota	41	4	45	—	—	—
Tennessee	40	10	50	6	8	14
Texas	283	59	342	2	2	2
Utah	17	5	22	2	10	37
Vermont	4	1	5	—	—	—
Virginia	5	9	14	5	7	86
Washington	7	1	8	4	10	42
West Virgina	9	1	10	—	—	—
Wisconsin	82	28	110	2	3	7
Wyoming	29	6	35	—	—	—
TOTAL	3,201	430	3,631	139	382	5,500

Source: Federal Reserve Board Data Base as of December 31, 1981.

Note: Data on holding companies with interstate subsidiaries is based on data from the District Federal Reserve Banks except in the 11th and 12th Federal Reserve Districts where we contacted the holding companies. This data based on December 31, 1981, figures, is a snapshot of a constantly changing situation and is not intended as an exhaustive listing.

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interstate offices of nonbank subsidiaries by section of the country. At least 4,613 offices of nonbank subsidiaries of out-of-state bank holding companies provide consumer finance services, by far the most popular type of interstate 4(c)8 activity for bank holding companies to engage in. The second most popular is the insurance agency activity (provided through 2,440 offices), followed by underwriting credit life (1,118 offices), servicing loans (1,995 offices), mortgage banking (623 offices) and leasing (580 offices).[13] Interstate offices that provide check verification, audit services, and credit cards are the least popular. Although these services are provided on an interstate basis, they don't require permanent physical presence.

The geographic distribution of these services is interesting. The South Atlantic (Census Region) states lead the nation in the number of activities provided through nonbank subsidiaries belonging to out-of-state holding companies. These South Atlantic states house 1,327 offices of out-of-state holding companies providing consumer finance services, 214 offices offering mortgage banking and 21 offices offering trust services. The Pacific states are the second most popular target for most 4(c)8 activities, but these states house less than half the number of activities provided through offices in the South Atlantic region. Quite obviously, a region's size plays a part in these statistics, but generally the primary targets for 4(c)8 activities appear to be the faster growing states with substantial populations. In terms of total number of activities offered through nonbank subsidiaries of out-of-state holding companies, California leads the way with 907, followed by Florida with 824, North Carolina with 769, Pennsylvania with 640, Ohio with 614, South Carolina with 558, Georgia with 557 and Texas with 542. The remaining 42 states house approximately the same number of activities offered through offices of nonbank subsidiaries of out-of-state holding companies as the total offered in these 8 states.

Interstate Offices by Primary Activity

As noted above, more than one 4(c)8 activity may be provided through a single subsidiary office. Many activities are low profile and normally provide a complementary service to some other 4(c)8 activity. For example, as Table 6 indicates, the insurance agent activity is provided at 2,440 locations, although the interstate offices of 4(c)8 subsidiaries primarily engaged in this activity number only 40. The same is true for underwriting credit life insurance; while credit life insurance is provided at 1,118 offices of 4(c)8 subsidiaries, only 56 are primarily engaged in this activity. Therefore, to assess the geographic extent to which bank holding companies are establishing a physical presence on an interstate basis, one should focus on the number of 4(c)8 offices by primary activity. A table detailing the number of these offices by primary activity and by region is available from the Atlanta Fed.

At least 5,500 offices of 4(c)8 subsidiaries are located outside the state in which the parent company resides. Four of the primary activities are what may be considered high profile activities: finance company, mortgage banking, industrial banking and trust services. While offices of some of the other primary activities establish the holding company's presence in an area, they are less visible to the public. In addition, these four highly visible activites accounted for 5,189 of the interstate 4(c)8 offices, or 95 percent of the total. Finance companies dominate as the most popular type of primary 4(c)8 activity. In total, subsidiaries of bank holding companies control 4,442 finance company offices outside the state in which the parent company resides. This one activity accounts for better than 80 percent of all interstate 4(c)8 offices.

A look at the geographic distribution of interstate offices of 4(c)8 subsidiaries may indicate which states or areas of the country will be the primary targets for interstate expansion if the prohibition on interstate banking is lifted. Map 3 shows by state the number of 4(c)8 offices controlled by out-of-state holding companies. In terms of total office locations, California has attracted more activity than any other state with 521 offices. Florida is a distant second with 372 offices, closely followed by North Carolina (367), Pennsylvania (320), Ohio (310) and Texas (289).[14] Five southeastern Atlantic coast states have attracted a good deal of the attention of out-of-state holding companies—Virginia, North

[13] Any location at which a customer may obtain credit life insurance which is reinsured by a holding company subsidiary is included in the 1,118 offices providing underwriting credit life.

[14] Pennsylvania has very attractive usury laws which may explain at least in part the degree of nonbank entry.

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Table 6. Interstate Nonbank Subsidiaries: Location of Activities by Region

TYPE OF ACTIVITY	New England	Mid Atlantic	South Atlantic	W. South Central	E South Central	North Central-East	North Central-West	Pacific	Mountain	TOTAL
Mortgage Banking	19	27	214	47	61	74	32	80	69	623
Finance Company	149	536	1,327	466	389	565	208	652	321	4,613
Credit Cards	0	0	5	0	0	0	1	0	0	6
Factoring	1	5	10	9	3	3	1	12	4	48
Industrial Bank	2	0	29	1	1	2	18	23	49	125
Servicing Loans	47	140	334	83	32	105	45	106	103	995
Trust Company	0	4	21	0	2	1	13	7	20	68
Financial Advisor	2	2	29	17	1	17	1	12	11	92
Leasing	30	86	167	53	14	114	23	49	44	580
Investment in Community Welfare	0	0	0	0	0	4	0	4	4	12
Data Processing	2	3	6	4	1	9	16	3	10	54
Insurance Agent	72	230	836	253	236	251	97	273	192	2,440
Underwriting Credit Life	21	45	407	106	83	78	65	159	154	1,118
Management Consulting	0	0	2	3	0	0	1	2	2	10
Money Orders, Travelers Checks	0	0	113	2	42	12	0	4	4	177
Check Verification	0	0	2	0	1	0	0	0	0	3
Audit Services	0	0	0	0	0	0	4	0	1	5
Total Per Region	345	1,078	3,502	1,044	866	1,235	525	1,386	988	
Total for U.S.										10,969

Source: Federal Reserve Bank of Atlanta

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Map 4
By Major 4(c)8 Activity and Number of Offices Located in each State
Finance Companies

Total: 4,442

Map 5
By Major 4(c)8 Activity and Number of Offices Located in each State
Mortgage Banking

Total: 584

Carolina, South Carolina, Georgia and Florida. Combined, these states constitute a land mass half again as large as California but house almost three times the number of 4(c)8 offices, 1,447 offices of out-of-state holding companies (27 percent of the total). Indeed, these five states and Pennsylvania, Ohio, Texas and California have been the most attractive for interstate expansion through 4(c)8 subsidiaries and, if we may use this as any indication, will probably be the most attractive targets for interstate bank expansion should the prohibition be removed.

Map 4, again, reveals that most interstate 4(c)8 activity has been consumer finance oriented. Over 83 percent of all interstate 4(c)8 offices in the nine states mentioned above as attractive targets were finance companies. In fact, 93 percent of all 4(c)8 offices in Pennsylvania are finance companies. This may be interpreted as evidence that these states would be especially attractive for consumer-oriented banks.

Map 5 shows a more or less consistent pattern for mortgage banking offices with the exception that Tennessee and Illinois should be added to our list of attractive states.

Footnote 15 lists the number of office locations of all 4(c)8 subsidiaries engaged primarily in offering trust services.[15] Florida is obviously the prime target for such activities—again a consumer or retail-oriented service. Part of this pattern, however, may be due to the relative leniency of restrictions that states place on entry via the trust route. Florida, for example has no restrictions on out-of-state organizations establishing trust companies in the state.

State laws restricting industrial banks also play a part in the geographic distribution of this 4(c)8 activity.[16] Although there is some activity in the Carolinas and Georgia, many states prohibit such organizations. A number of midwestern and western states do allow industrial banks, and that is where most such offices are located.

[15]Trust companies (number of offices in each state) - Florida (20), Arizona (9), Montana (8), North Dakota (3), South Dakota (4), New York (3), Nebraska (2), Pennsylvania (1), Hawaii (1), California (1), Illinois (1), and Tennessee (1).

[16]Industrial Banks (number of offices in each state) - Colorado (40), North Carolina (12), Kansas (12), California (10), Georgia (9), South Carolina (7), Washington (8), Utah (20), Hawaii (2), Arizona (10), Nebraska (1), and Florida (1).

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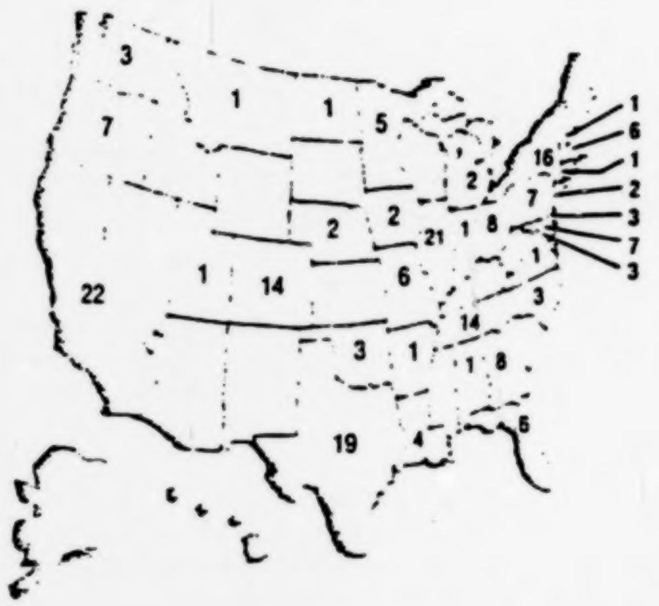
Map 6
Interstate Loan Production Offices
Located in each State



Total: 202

Map 7
Interstate Edge Act Office Domestic Banking
Organization

Source: Federal Reserve Bank of New York
(As of Oct. 1982)

Total: 143

To the extent that offices primarily engaged in the leasing activity may be used to indicate the wholesale banking function, it appears that California, Texas and Ohio will be prime targets for wholesale banking should the laws permit. Each of these states houses at least 10 offices of out-of-state bank holding companies' 4(c)8 subsidiaries. North Carolina, Illinois Missouri and Florida also would appear to be desirable targets from this perspective.[17]

Other Nonbank Subsidiaries

In addition to 4(c)8 subsidiaries, banking organizations are permitted to establish loan production offices and Edge Act corporations on an interstate basis. Loan production offices can do little more than a calling officer, but they are useful in establishing a wholesale presence in an area. Edge Act offices are also aimed at wholesale customers but are limited to dealing with organizations engaged in international trade.

Since regulatory agencies do not track data on loan production offices, it was necessary to survey banking organizations directly. Only the largest banking organizations are likely to commit resources to loan production offices, especially in light of the fact that calling officers may provide the same services without a physical presence in an area. Therefore we surveyed the top 200 banking organizations in the country and found that they controlled a total of 202 loan production offices.

Table 7 shows the number of banking organizations in each state that have established out-of-state loan production offices, the number of offices established and the number of states in which these offices have been placed. Map 6 shows that California, Illinois, Texas, New York, Colorado and Tennessee have attracted more loan production offices than other states.

Following the same logic, Edge Act corporations are established in order to follow the geographic distribution of one's customers engaged in international trade. There are 143 interstate

[17]Leasing activities (number of offices in each state) - Texas (11), California (10), Ohio (10), Illinois (8), North Carolina (8), New Jersey (5), Missouri (5), Florida (5), New York (4), Colorado, Michigan, Kentucky, Tennessee, Pennsylvania (3 each), Delaware, Washington, Minnesota (2 each), Montana, Arizona, New Mexico, Nebraska, Louisiana, Georgia, South Carolina, Connecticut (1 each).

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Table 7. Interstate Loan Production Offices

Parent State	Number of Organizations Establishing Loan Production Offices	Number of Interstate Loan Production Offices Maintained	Number of States Entered by LPO's
California	5	36[a]	14
District of Columbia	1	7	7
Florida	1	1	1
Illinois	4	31	13
Kentucky	2	8	7
Maryland	1	3	3
Massachusetts	3	14	12
Michigan	1	1	1
Minnesota	2	5	5
Missouri	2	22[b]	6
New Jersey	1	2	2
New York	8	31[c]	13
North Carolina	2	4	2
Oklahoma	1	1	1
Pennsylvania	2	4	2
Rhode Island	2	6	5
Texas	2	5	3
Virginia	2	12	5
Washington	2	9	7
TOTAL	44	202	34

Notes:
[a] Only 3 LPOs from California are in New York
[b] General Bancshares Corporation of St. Louis, MO has full service banks in Missouri, Illinois, and Tennessee. They have 13 LPOs in Tennessee and 4 LPOs in Illinois.
[c] 10 of the 31 are in California

Source: FRB—Atlanta Survey of Largest 200 Banking Organizations; data as of December 31, 1982.

Edge Act offices of domestic organizations located in the United States. Map 7 shows their geographic distribution. Predictably, states with international trade centers have attracted the most Edge Act offices. New York attracted the largest number, 31, closely followed by Florida with 25 offices. California follows with 23, Texas with 17 and Illinois is a distant fifth with 11 Edge Act offices. New York, Florida, California and Texas are prime targets for this type of wholesale banking. Since only the largest banks may offer services needed by international corporations, banking organizations in the money centers have already located offices to serve these needs. For example, New York banks have established 15 Edge Act offices in California and California organizations have established five such offices in New York. Interstate banking would allow these organizations to provide little more wholesale services than they are providing today.

Summary of Interstate Activity

Table 8 summarizes by state the number of interstate offices of out-of-state banking organizations. The most impressive aspect is the fact that domestic banking organizations control at least 7,383 interstate offices and, if we include interstate offices of foreign banking organizations, the total reaches 7,840. This compares to a total of 55,440 banking offices in the nation. Almost 1,500 of the identified interstate offices supply all banking services. The remaining offices are nonbank subsidiaries offering a more limited number of banking type services. The sheer number of interstate offices controlled by holding companies is impressive, given the prohibition on interstate banking.

Holding companies may use a number of avenues to serve both interstate retail and wholesale customers. The only area in which they cannot effectively compete for consumer accounts is in the convenience area—providing

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Table 8. Summary of Interstate Activity

LOCATION	GRANDFATHERED DOMESTIC Holding* Companies	GRANDFATHERED DOMESTIC Banks	GRANDFATHERED DOMESTIC Branches	GRANDFATHERED FOREIGN* Holding* Companies	GRANDFATHERED FOREIGN* Banks	GRANDFATHERED FOREIGN* Branches	FOREIGN BANKS Agency	FOREIGN BANKS Edge	FOREIGN BANKS Branch	States* With Reciprocal Agreement	Preferred* Stock Deals Filed With Board	Interstate* S&Ls	Offices of 4(c) 8 Subs	Loan Production Offices	Edge Act Corporations	Total Offices per State
Alabama											1	1	107	1		108
Alaska										✓			4	1		5
Arizona	1	1	161										159			321
Arkansas													3			3
California				8	8	148	63	2	2			2	521	22	23	787
Colorado	1	3	7									1	158	14		182
Connecticut											1		64	1		65
Delaware	12	12	40							O			27	3	8	87
District of Columbia									1			2	2	3		6
Florida	2	2	188				22	8		□	1	7	372	6	25	621
Georgia							10				1	2	253	8	5	278
Hawaii				1	1	16	2					2	39			57
Idaho	2	2	107									1	47			156
Illinois	1	3	4	1	1	1		3	38	□		1	132	21	11	212
Indiana													99	1		100
Iowa	1	11	50							□	1		42	2		105
Kansas												1	78			78
Kentucky												1	81			81
Louisiana							1						184	4	1	170
Maine										✓	1		1			1
Maryland	1	8	30									2	82	7		121
Massachusetts									4	✓	8	1	58	8	3	81
Michigan													56	2		58
Minnesota											1		34	5	4	43
Mississippi													89			59
Missouri												1	75	8	2	83
Montana	3	25	48									2	28	1		102
Nebraska	1	5	39										28	2		74
Nevada	1	1	86									1	21			88
New Hampshire													20	1		21
New Jersey													110	2		112
New Mexico	1	8	35										44			84
New York	1	2	27	3	3	39	18	2	37	✓	4	3	188	18	31	331
North Carolina													387	3		370
North Dakota	3	34	110										73	1		188
Ohio											2		310	8	4	322
Oklahoma											1		76	3		79
Oregon	1	1	189						7			4	83	7	3	270
Pennsylvania									8		2		320	7	2	335
Rhode Island													13			13
South Carolina											1		229			229
South Dakota	3	12	80							O			18			108
Tennessee	2	2	27										158	14		202
Texas								8			1	8	289	18	17	334
Utah	1	1	38							✓		1	37	1		74
Vermont													4			4
Virginia	1	8	83									1	227	1		297
Washington	1	1	86						10			2	114	3	8	219
West Virginia													40			40
Wisconsin	3	8	22										39		1	68
Wyoming	2	4	4									1	10			18
TOTALS	48	141	1,397	13	13	303	116	22	103	10	20	48	5,800	202	143	7,840

Notes

O - These states allow entry of limited purpose banks

□ - These states allow expansion of interstate grandfathered banks

* - These columns are not included in total number of offices

Δ - Six of the foreign bank holding companies own only one bank, but the bank is located outside the home state of the foreign banking organization.

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brick-and-mortar offices to attract small and medium sized consumer accounts.

On the wholesale side, holding companies are providing a wide array of interstate financial services, some of which require a physical presence but many of which do not. Many of these corporate services may be provided through nonbank subsidiaries, which are free to establish interstate offices. In addition, large banking organizations are providing large corporate customers with banking services not requiring physical interstate offices. These banking organizations appear to be competitively handicapped only in providing certain wholesale banking services to medium and especially small business customers. These customers still depend to a large extent on locally controlled banks.[18]

It appears, however, that as time goes by more and more of the financial services required by medium and small businesses will be targets for large banking organizations supplying these services through 4(c)8 provisions. It simply is not necessary for a banking organization to maintain a facility that both accepts deposits and makes loans to be competitive across state lines. The larger holding companies have already established their nonbank interstate presence.

Some of the smaller banking organizations having a regional scope are moving quickly to establish formal and informal agreements to form interstate networks if the interstate prohibitions are removed. Their rationale seems to be a perceived need to become large enough to compete with the money center banks on an equal footing. Although the smaller banking organizations make the assumption, the question is whether larger banking organizations are under any strong pressure to establish a nationwide interstate banking network involving brick-and-mortar offices. The answer must be a modified no.

First, the removal of Regulation Q means that banks will be required to pay money market rates for a larger proportion of their small and medium size deposits. The day of bank deposit customers subsidizing banks through low interest is over. Take this subsidy away and add in the expense of operating distant offices and one conclusion is clear: large banks have no great incentive to use brick and mortar facilities to collect deposits except possibly in the most attractive high growth markets.

From the consumer's standpoint the idea of interstate networks is also questionable. As banks are required to pay money market rates for more of their funds, they necessarily will have to pass the costs along to consumers through direct pricing on services. Since an interstate banking network will be expensive to maintain, will customers be willing to pay for the marginal benefits associated with "unlimited" geographic access to their accounts? The answer is probably "no," given the number of less costly alternatives available that do not require an interstate network. For these reasons it does not appear that the consumer will lead the way to interstate banking. Supply in this case will definitely follow demand—and little demand exists for this type of service.

Too many avenues allow banking organizations to provide interstate financial services on a less costly basis to believe that nationwide interstate brick-and-mortar expansion is inevitable.

Interstate bank expansion will occur in the absence of the interstate prohibition, but, because of the prodigious amount of interstate activity already in place, it will evolve slowly and will be geographically limited to the more attractive markets. There is some danger that small and medium sized banking organizations might be panicked into building interstate banking systems large enough to fend off money center banks. In the short run this may create some inefficient organizations. Taking a longer view, however, market forces will correct these inefficiencies. The larger money center banks, on the other hand, quite obviously will become active in the more attractive markets—but are unlikely to establish comprehensive nationwide interstate networks because they have already established themselves through nonbank subsidiaries.

—David D. Whitehead

[18] David Whitehead, "Sixth District Survey of Small Business Credit," Economic Review Federal Reserve Bank of Atlanta (April 1982), pp. 42-48.

Pam Frisbee contributed valuable research assistance in the preparation of this article. The author also wishes to thank the other District Federal Reserve Banks for their vital contributions. A longer, more detailed version of this study is available from the Information Center, Federal Reserve Bank of Atlanta.

1014000

Supreme Court of the United States

No. 84-1274

BOARD OF GOVERNORS OF THE
FEDERAL RESERVE SYSTEM, PETITIONER,

v.

DIMENSION FINANCIAL CORP., ET AL.

ORDER ALLOWING CERTIORARI. Filed *April 29, 1985*,

The petition herein for a writ of certiorari to the *United States Court of Appeals for the Tenth Circuit* is granted.

Justice White took no part in the consideration or decision of this petition.

(12)

No. 84-1274

In the Supreme Court of the United States

OCTOBER TERM, 1984

BOARD OF GOVERNORS OF THE
FEDERAL RESERVE SYSTEM, PETITIONER

v.

DIMENSION FINANCIAL CORPORATION, ET AL.

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*ON WRIT OF CERTIORARI TO THE
UNITED STATES COURT OF APPEALS
FOR THE TENTH CIRCUIT*

BRIEF FOR THE PETITIONER

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QUESTION PRESENTED

Section 2(c) of the Bank Holding Company Act of 1956 (12 U.S.C. 1841(c)) defines a "bank" as any institution that "(1) accepts deposits that the depositor has a legal right to withdraw on demand, and (2) engages in the business of making commercial loans." The question in this case is whether, in order to prevent evasion of the Act through manipulation of this definition, the Federal Reserve Board properly exercised its discretion in determining that the first element of this definition includes NOW (negotiable order of withdrawal) checking accounts and that the commercial loan element includes the purchase of commercial paper, retail installment loans, and similar instruments, which result in extensions of credit to commercial enterprises.

PARTIES TO THE PROCEEDING

In addition to the parties named in the caption, Daniel T. Carroll, Harold D. Dufek, William T. Mitchell, Ronald L. Shaffer, A. Gary Shilling, the State of Ohio, Ohio Division of Savings and Loan Associations, Ohio Deposit Guaranty Fund, Horizon Savings and Loan Company, Permanent Savings and Loan Association, Financial Institutions Assurance Corporation, First Bancorporation, Colorado Industrial Bankers Association, Fort Lupton Industrial Bank, Monroe Industrial Bank, Castle Rock Industrial Bank, Ark Valley Industrial Bank, Household Lamar Industrial Bank, Household Alamosa Industrial Bank, Household Valley Industrial Bank, Household Salida Industrial Bank, Copper State Thrift & Loan Company, and Copper State Financial Corporation were petitioners in the court of appeals. American Financial Services Association and Household Finance Corporation were intervenors in the court of appeals.

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BRIEF FOR THE PETITIONER

OPINION BELOW

The opinion of the court of appeals (Pet. App. 1a-19a) is reported at 744 F.2d 1402.

JURISDICTION

The judgment of the court of appeals was entered on September 24, 1984. On December 13, 1984, Justice White extended the time for filing a petition for a writ of certiorari to January 22, 1985. On January 14, 1985, Justice White further extended the time for filing to and including February 6, 1985. The petition was filed on that date and was granted on April 29, 1985. The jurisdiction of this Court rests on 28 U.S.C. 1254(1).

STATUTORY AND REGULATORY PROVISIONS INVOLVED

12 U.S.C. 1841(c) provides in relevant part:

"Bank" means any institution * * * which (1) accepts deposits that the depositor has a legal right to withdraw on demand, and (2) engages in the business of making commercial loans.

12 C.F.R. 225.2(a)(1) provides:

"Bank" means any institution organized under the laws of the United States that

(i) accepts deposits that the depositor has a legal right to withdraw on demand and

(ii) engages in the business of making commercial loans. For the purposes of this definition

(A) "deposits that the depositor has a legal right to withdraw on demand" (hereinafter "demand deposits") means any deposit with transactional capability that, as a matter of practice, is payable on demand and that is withdrawable by check, draft, negotiable order of withdrawal, or other similar instrument; and

(B) "commercial loans" means any loan other than a loan to an individual for personal, family, household, or charitable purposes, and includes the purchase of retail installment loans or commercial paper, certificates of deposit, bankers' acceptances, and similar money market instruments, the extension of broker call loans, the sale of federal funds, and the deposit of interest-bearing funds.

STATEMENT

1. The Bank Holding Company Act of 1956 (BHC Act or Act) establishes a comprehensive federal framework governing the banking and nonbanking activities and acquisitions of bank holding companies in order to effectuate the national policies requiring a separation of

banking and commerce in this country and maintaining local control over banking expansion across state borders. *Northeast Bancorp* v. *Board of Governors*, No. 84-363 (June 10, 1985), slip op. 2; *Lewis* v. *BT Investment Managers, Inc.*, 447 U.S. 27, 38, 46 (1980). The Act charges the Federal Reserve Board with exclusive authority to administer the Act and to issue such orders or regulations as may be necessary to enable it to carry out the purposes of the Act and to prevent evasions thereof. 12 U.S.C. 1844(b).

The scope of coverage of the Act is determined by the Act's key definition of "bank" as "any institution * * * which (1) accepts deposits that the depositor has a legal right to withdraw on demand, and (2) engages in the business of making commercial loans." [1] 12 U.S.C. 1841 (c). The term "bank holding company," in turn, means "any company which has control over any bank." 12 U.S.C. 1841(a)(1).

Section 3 of the BHC Act requires prior Board approval for the formation and expansion of bank holding companies through acquisitions of banks, under specified competitive, financial, managerial, and community convenience and needs factors. 12 U.S.C. 1842(a) and (c). Section 3(d) of the Act, known as the "Douglas Amendment," prohibits the Board from approving any application by a bank holding company to acquire a bank located in another state without the consent of the state. 12 U.S.C. 1842(d). Section 4 of the Act (12 U.S.C. 1843(a), (c)(8)) prohibits bank holding companies from engaging in activities other than those of banking or managing or controlling banks and activities the Board

[1] Section 2(c) excepts from this definition of "bank" federal savings banks and federal savings and loan associations and state savings and loan associations and similar thrift institutions the accounts of which are insured by the Federal Savings and Loan Insurance Corporation. 12 U.S.C. 1841(c). Companies controlling such institutions are subject to the Savings and Loan Holding Company Act. 12 U.S.C. 1730a.

determines to be "closely related to banking." In order to authorize a bank holding company to engage in such an activity, the Board must find that the expected public benefits of the activity outweigh possible adverse effects, such as undue concentration of resources, decreased or unfair competition, conflicts of interest, or unsound banking practices. 12 U.S.C. 1843(c)(8). See *Securities Industry Association* v. *Board of Governors*, No. 83-614 (June 28, 1984), slip op. 2-3. Bank holding companies are subject to registration and reporting requirements as well as to the broad examination, supervisory, and enforcement powers of the Board. 12 U.S.C. 1844(c), 1847, 1818(b)(3).

2. The issue in this case is the applicability of this regulatory framework to companies controlling so-called "nonbank banks"—national and state chartered banks, industrial loan companies, and similar institutions that seek to escape treatment as a bank under the Act by claiming not to offer one of the two services that define a bank for purposes of the Act, while offering a functionally equivalent service.

In several isolated cases in the period from 1970 to early 1981, the Board and its staff issued advisory letters that tended to narrow the scope of the commercial loan element of the bank definition (J.A. 93A-105A, 110A-112A). By 1982, however, advances in computer and communications technology and inflation, among other reasons, had generated a major thrust by commercial firms into banking and by industrial banks into NOW (negotiable order of withdrawal) checking accounts and commercial lending services. A NOW account is an interest-bearing checking account that is subject to a theoretical, never-exercised, right of the depository institution to require prior notice of withdrawal from the account and is available generally only to individuals. Similarly, bank holding companies have sought to expand their banking activities geographically across state lines.

Nonbank banks developed as the vehicles by which these nonbanking and banking companies sought entry into or an expansion within the banking system (see Pet. App. 24a, 31a).

The Board's response to the proliferation of nonbank banks evolved in three steps, from decisions made in two specific cases to a general rule adopted after rulemaking proceedings. First, in April 1982, prompted by the expansion in the late 1970's and early 1980's of NOW account and commercial loan powers for industrial banks (Pet. App. 24a, 42a), the Board interpreted the demand deposit element in the BHC Act's definition of bank to include NOW accounts.[2]

Second, when in December 1982, a major securities firm acquired a state chartered, federally insured nonbank bank (J.A. 71A-89A), it became evident that many more commercial firms and bank holding companies would utilize the nonbank bank device to avoid the Act's policies. It also became clear to the Board that a liberal construction of the bank definition that permitted such acquisitions would, contrary to the intention of Congress, result in significant evasions of the basic purposes of the BHC Act by allowing combinations of commercial and banking firms that would inevitably raise the potential hazards that Congress sought to prevent by the adoption of the BHC Act (Pet. App. 24a-25a). Accordingly, to limit the use of the nonbank bank device as a means to avoid coverage of the Act, the Board interpreted the term commercial loans as used in the Act's bank definition to in-

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[2] The Board approved the acquisition by respondent First Bancorporation of a Utah chartered industrial loan company on condition that the industrial loan company not engage both in making commercial loans and accepting NOW accounts, which the Board concluded must be regarded as demand deposits for purposes of the Act. *First Bancorporation (Beehive Thrift and Loan Co.)*, 68 Fed. Res. Bull. 253 (1982) (J.A. 59A-64A).

clude the purchase of commercial paper and similar money market instruments.[3]

Third, in May 1983, in response to the increase in the number of nonbank banks (Pet. App. 25a), the Board proposed for public comment an amendment to Regulation Y (12 C.F.R. Part 225) that would incorporate these interpretations (R. 203, 256).[4]

On December 30, 1983, after careful consideration of the comments received, the Board adopted, with only minor modifications, the proposed definitions of demand deposits and commercial loans, acting pursuant to its authority under section 5(b) to issue regulations to carry out the purposes and prevent evasions of the Act (Pet. App. 20a-22a, 61a). In a detailed Appendix accompanying the revised regulation (*id.* at 20a-61a), the Board reaffirmed its belief that the definitions are necessary to prevent the threatened nullification of the fundamental purposes of the BHC Act caused by the growing wave of acquisitions of nonbank banks (*id.* at 21a-31a).

The Board further stated, after reviewing the legislative history of the Act's definition of bank, that Congress intended the provisions of the bank definition concerning the taking of demand deposits and the making of commercial loans to exclude only limited classes of entities, such as savings banks and trust companies, whose activities were narrowly confined by law (Pet. App. 22a-

[3] In opposing before the Federal Deposit Insurance Corporation the proposed acquisition by the Dreyfus Corporation, an organization engaged in the underwriting of securities, of an FDIC-insured state chartered nonbank bank, the Board determined that the term "commercial loans" as used in the definition of "bank" includes the purchase of money market instruments, such as commercial paper, bankers' acceptances and similar lending vehicles (J.A. 65A-70A).

[4] The proposed definitional provisions were part of a proposed comprehensive revision of Regulation Y, which implements the BHC Act (R. 208).

24a).[5] The Board found, however, that after 1980 the powers of industrial banks substantially expanded to include accepting NOW checking accounts and making commercial loans, and these institutions became eligible for FDIC insurance (*id.* at 24a). The Board also found that the recent widespread acquisition of FDIC-insured national or state banks by insurance, securities, industrial, and commercial organizations, based upon their narrow construction of the Act's definition of bank, frustrated the framework of regulation created by the Act (*id.* at 24a-27a). In particular, the Board determined that the combination of nonbank banks with commercial and industrial enterprises, free of the protections of the Act, could give rise to precisely the kind of preferential and abusive credit practices the Act was meant to abolish (*id.* at 28a-31a). The Board also made clear that the proliferation of nonbank banks permits "expansion of banking across state lines without either state authorization or Congressional approval as is now required by law" (*id.* at 31a).

With respect to the proposed definitions, the Board noted that "NOW accounts in practice perform the same function as conventional demand deposits, are advertised and used in a manner indistinguishable from conventional bank checking accounts, and are subject to the same reserve requirements as conventional demand deposits" (Pet. App. 38a). The Board found that the imposition of a prior notice requirement would be a virtual practical impossibility with respect to NOW accounts (*id.* at 39a-40a).[6] The amended Regulation Y ac-

[5] The Board noted that, as originally enacted, the BHC Act defined bank as any national or state bank, savings bank, or trust company. In 1966, Congress eliminated the charter test in favor of a functional demand deposit test in order to exclude industrial and savings banks that then did not accept checking accounts. In 1970, Congress added the requirement that a bank that accepted demand deposits must also be in the business of making commercial loans, in order to exempt possibly only a single trust company (*id.* at 22a-23a).

[6] By invoking the notice requirement, the institution would refuse payment to the third party payee of the NOW account check,

cordingly defines "deposits that the depositor has a legal right to withdraw on demand" (12 U.S.C. 1841(c)(1)) to mean:

> any deposit with transactional capability that, as a matter of practice, is payable on demand and that is withdrawable by check, draft, negotiable order of withdrawal, or other similar instrument * * *.

12 C.F.R. 225.2(a)(1)(A).[7] The Board also found that the purchase of money market and similar instruments represents the provision of short-term funds "to commercial organizations * * * for working capital or current operations" (Pet. App. 48a-49a). The regulation accordingly defines "commercial loans" (12 U.S.C. 1841 (c)(2)) to mean:

> any loan other than a loan to an individual for personal, family, household, or charitable purposes, and includes the purchase of retail installment loans or commercial paper, certificates of deposit, bankers' acceptances, and similar money market instruments, the extension of broker call loans, the sale of federal funds, and the deposit of interest-bearing funds.

12 C.F.R. 225.2(a)(1)(B). The regulation thus includes as a bank within the meaning of the BHC Act any institution that offers the NOW checking account form

and presumably such payees "would thereafter refuse to accept NOW drafts drawn on that institution" (*id.* at 39a, 40a & n.22). The impracticability of requiring prior notice of withdrawal is heightened by the fact that under federal law, if the notice is invoked, it must be required for withdrawals from every other account at the institution subject to the same notice of withdrawal provisions. *E.g.*, 12 C.F.R. 217.5(a).

[7] The Board noted that other types of transaction accounts, such as telephone transfer accounts and accounts accessible through automated teller machines, also might fall within the definition (Pet. App. 43a), but explained that "it is unlikely that there would be a significant number of depository institutions offering these accounts that do not also offer NOW or other checking accounts" (*ibid.*). The principal focus of the Board's ruling therefore was on NOW accounts (see *id.* at 32a-45a).

of demand deposits and makes commercial loans or that accepts demand deposits and makes commercial loans in any form, including purchases of short-term commercial debt obligations.

3. After the promulgation of amended Regulation Y, respondents filed petitions challenging the regulation in the Fourth, Sixth and Tenth Circuits. These petitions all were transferred to the Tenth Circuit pursuant to 28 U.S.C. 2112(a). That court then invalidated both the demand deposit and the commercial loan aspects of the Board's regulation (Pet. App. 19a).

a. Concerning the demand deposit definition, the court of appeals relied entirely (Pet. App. 4a) on its earlier decision in *First Bancorporation* v. *Board of Governors*, 728 F.2d 434 (1984). In that decision, the court of appeals overturned the Board's earlier ruling (see n.2, *supra*) that NOW accounts offered by a Utah industrial loan company that also made commercial loans must be regarded as demand deposits within the meaning of the BHC Act's definition of bank. In reaching its conclusion, the court in *First Bancorporation* noted that, under Utah law, industrial loan companies must reserve the right to demand 30 days' notice prior to the withdrawal of funds from a NOW account. 728 F.2d at 435. As a result, the court summarily concluded, a depositor whose funds are held by a Utah industrial loan company has "no legal right of withdrawal on demand" (*id.* at 436). The court also concluded that the statutory language must be interpreted narrowly because Congress used the "legal right to withdraw" formula rather than a broader "payable on demand" test that had been suggested by the Board (*id.* at 436-437). The court reached its conclusion without examining the Board's ruling in light of the underlying purposes of the Act.

b. On the commercial loan definition, the court below first explained that "the new definition of [commercial loans] is not in accord with common usage" (Pet. App. 8a), and that the Board in the past had ruled that an

institution may engage in money market transactions without subjecting itself to treatment as a bank (*id.* at 5a-6a). "Such a complete change [in position]," the court opined, "and one that is a redefinition and expansion of jurisdiction by an agency requires that different standards be met than are demanded in a typical administrative redefinition not involving such elements" (*id.* at 9a). The court also found support for its holding in the legislative history, concluding that the commercial loan proviso was added to the statute specifically to exempt from the Act only one institution, the Boston Safe Deposit & Trust Company; yet when the proviso was added, the court stated, Congress and the Board knew that the company was engaging in money market transactions of the sort that revised Regulation Y now treats as commercial loans (*id.* at 10a-11a). The court also noted that other federal agencies have disagreed with the Board's definition of commercial loan (*id.* at 7a, 17a).

Finally, with no analysis of the basic objectives of the Act, the court of appeals opined that the Board "does not have the broad scope to work in as do many other agencies. * * * Instead, the BHC [Act] limits the subject matter of the Board's functions basically to anticompetitive considerations" (Pet. App. 12a). In combination with the other factors noted above, this consideration led the court to hold that "the limited authority of the Board [does not] permit[] it to itself bring about the change here attempted and a change in its own jurisdiction no matter how necessary it perceives the change to be * * *" (*id.* at 17a). The court of appeals therefore broadly enjoined the Board from implementing or enforcing the revised Regulation Y (*id.* at 19a).

SUMMARY OF ARGUMENT

The Bank Holding Company Act embodies the fundamental national policies that Congress has established to govern the companies that own or control banks. These policies require a separation of banking and commerce in

order to maintain banks as impartial providers of credit, to avoid conflicts of interest, unfair competition, undue concentration of resources, and the transmission of unregulated financial risks to the banking system, as well as to maintain local control over banking expansion across state boundaries. See *Northeast Bancorp*, slip op. 2; *Lewis* v. *BT Investment Managers, Inc.*, 447 U.S. at 38, 46. The issue in this case is the applicability of the Act to companies that seek to secure the benefits of affiliation with a bank, while avoiding these policies through ownership of so-called "nonbank banks."

Nonbank banks, although chartered as banks or similar deposit-taking institutions, claim exemption from the Act because they either do not offer deposits that the depositor has a legal right to withdraw on demand ("demand deposits") or do not make commercial loans —the two banking services that define a bank under the Act. 12 U.S.C. 1841(c). In many cases, however, the nonbank banks continue to offer a functionally equivalent service in the form of NOW (negotiable order of withdrawal) accounts (checking accounts that are subject to a never-exercised prior notice of withdrawal requirement) or the purchase of comercial paper and similar instruments that represent an extension of credit to a commercial organization.

In view of the rapid proliferation of nonbank banks in the early 1980's and the Board's findings that these institutions create a significant potential for evasion of the Act, the Board in December 1983, promulgated regulations aimed at identifying situations in which the ownership of a nonbank bank constitutes a prohibited evasion of the Act. For this purpose, the Board defined the demand deposit element of the Act's bank definition as including the functionally equivalent NOW account and the commercial loan element as including the purchase of money market instruments such as commercial paper, bankers' acceptances, and similar transactions. 12 C.F.R. 225.2(a)(1)(A) and (B).

The definitions established by the Board are based on the Board's conclusion that the fundamental objectives of the BHC Act would be substantially undermined through the acquisition of nonbank banks that offer NOW accounts and make commercial loans, or that take conventional demand deposits and purchase money market instruments that amount to commercial lending. The ability of a commercial, securities, insurance or industrial company to acquire a bank exercising these powers produces the very type of combinations of banking and commerce the BHC Act is intended to prevent. The nonbank bank device allows these companies to escape the comprehensive regulatory framework Congress established for companies that own banks, including important safety and soundness, anti-tying, conflicts of interest, concentration of resources, and insider lending provisions designed for the protection of the banking system and the public interest.

In addition, the nonbank bank device allows bank holding companies, as well as nonbanking companies, to acquire banks on an interstate basis without regard to provisions of the Act prohibiting interstate acquisitions of banks (as defined in the Act) without the host state's approval. 12 U.S.C. 1842(d). Such acquisitions of nonbank banks are in direct contravention of the policy of the Act to maintain local control over banking within state borders.

The separate legislative histories of both the demand deposit and commercial loan elements of the Act's bank definition, which were added in 1966 and 1970, respectively, do not indicate a congressional intent to allow a major departure from the overall regulatory and supervisory framework established for bank holding companies through the creation of a new class of exempt depository institutions. Rather, the intent in 1966 was to exempt small, localized industrial and savings banks that dealt with individuals as savers and borrowers and that did not offer checking accounts or commercial banking services, and in 1970 to exclude institutions exercising limited trust functions, in fact, perhaps, only a single institution. S. Rep. 1179, 89th Cong., 2d Sess. 7 (1966); H.R. Rep. 1747, 91st Cong., 2d Sess. 23 (1970).

The nonbank banks that now seek to take advantage of the changes in the bank definition adopted in 1966 and 1970 are not the same type of institutions that Congress intended to exclude. Industrial banks, such as the respondents in this case, have now obtained authority to offer NOW checking accounts and commercial lending services (Pet. App. 24a and 42a). The over sixty nonbank banks that are listed in the Appendix, *infra*, are mainly owned by large commercial, industrial, securities, and insurance firms engaged in a wide variety of businesses prohibited to banking organizations, and do not in the main limit their activities to trust and other fiduciary services, the basis upon which Congress added the commercial loan element to the bank definition in 1970. In these circumstances, it strains credulity to accept the notion put forward by respondents that Congress, without debate or discussion, by its 1966 and 1970 Amendments to the Act, intended to overturn the rules it was simultaneously establishing to apply comprehensive limits on the combination of banking and commercial activities and on interstate banking expansion without specific state approval.

Because the growth of nonbank banks will plainly frustrate the purposes for which the BHC Act was adopted, the Board, contrary to the view of the court of appeals below, acted appropriately and within its express authority to adopt regulations as necessary to carry out the purposes and prevent evasion of the Act, in promulgating the challenged demand deposit and commercial loan regulations.

A.

The inclusion of NOW accounts within the scope of demand deposits is entirely consistent with the legislative history and terms of the BHC Act and is necessary to carry out the Act's purposes.

NOW accounts function as the equivalent of conventional demand deposit checking accounts because they are freely withdrawable by check and because the notice of withdrawal requirement is not, and cannot practicably be, exercised. The legislative history of the Act shows unmistakably that Congress meant the "legal right to withdraw on demand" language in the bank definition to cover institutions that accept checking accounts. Congress utilized this terminology not because it intended the legal rights of depositors to be decisive, but because it wished to cover "checking accounts * * * the commonly accepted test of whether an institution is a commercial bank." S. Rep. 1179, 89th Cong., 2d Sess. 7 (1966). The "legal right to withdraw on demand" terminology designated the only type of checking account then in existence. This provision was intended to exclude industrial banking companies and similar organizations because they did not accept checking accounts and provided essentially savings accounts and consumer-oriented services. See 112 Cong. Rec. 12385-86 (1966). The only other court of appeals that has interpreted the demand deposit element of the bank definition recognized that Congress was not concerned with the legal rights of depositors, but with the functional nature of the deposit. *Wilshire Oil Co.* v. *Board of Governors*, 668 F.2d 732, 739 (3rd Cir. 1981), cert. denied, 457 U.S. 1132 (1982).

In addition, NOW accounts fall within the literal language of the bank definition because a NOW account depositor in fact has a legal right to withdraw funds from the account until the prior notice of withdrawal requirement is actually invoked. Because funds are withdrawn from NOW accounts by checks given directly to third party payees, requiring prior notice of withdrawal with respect to a NOW account is practicably impossible [8] and would defeat the very purpose of NOW accounts—to operate as demand checking accounts. Indeed, in recognition of the impracticability of ever invoking notice of withdrawal on NOW accounts, these instruments are treated in calculating the nation's money supply for monetary control purposes identically to currency and demand deposits. See, *e.g.*, 71 Fed. Res. Bull. A3 n.4 (July 1985).

Finally, the Board's coverage of NOW accounts as demand deposits is necessary to prevent evasion of the Act in view of the functional equivalency of the two accounts. Since NOW accounts and conventional demand deposits are operationally equivalent, a corporate parent may escape the Act by causing its subsidiary bank to offer NOW accounts in place of conventional checking accounts, while continuing to make commercial loans and to provide virtually all of the other services of a commercial bank. The potential for a substantial and widespread evasion of the fundamental policies of the Act through such arrangements is evident. Indeed, Congress itself has recognized that NOW accounts, although only available to individuals, are functionally equivalent to demand deposits and must be treated as such in order to prevent evasion of statutory provisions governing demand deposits (Pet. App. 40a-42a). The Third Circuit also correctly recognized that the Board is authorized to penetrate the form of deposit arrangements to reach accounts that in substance function as demand deposits in order to prevent evasion of the Act's bank definition. *Wilshire Oil Co.*, 668 F.2d at 739.

[8] The impracticability of invoking the notice requirement on NOW checking accounts is further evidenced by the fact that, under federal law, the notice requirement may not be imposed selectively but must be invoked for all accounts at the particular institution that are subject to the same notice of withdrawal requirements. See, *e.g.*, 12 C.F.R. 217.5(a).

B.

The Board's definition of the commercial loan element of the bank definition also is consistent with the terms and legislative history of the Act and necessary to effectuate the purposes of the Act.

There is no dispute that the transactions included in the Board's definition of commercial loan each establish a debtor-creditor relationship and result in the extension of funds to commercial enterprises to finance inventory or other working capital needs—the traditional hallmarks of a commercial loan. *United States* v. *Connecticut National Bank*, 418 U.S. 656, 665 (1974). Thus, the commercial loan definition adopted by the Board is consistent with the terms of the Act.

Moreover, the treatment of these types of transactions as commercial loans is warranted to prevent evasion of the Act that would otherwise result by allowing the ownership by a nonbanking company of a bank that accepts demand deposits and engages in the equivalent of commercial lending through these types of transactions. The legislative history demonstrates that the exemption from the Act for institutions that do not make commercial loans was intended to be interpreted "as narrowly as possible." H.R. Rep. 1747, *supra*, at 23 (1970). That the exemption for noncommercial lending institutions was not meant to exclude a large number of institutions is evidenced by the fact that the major thrust of the 1970 Amendments to the Act, which added the commercial loan element, was to broaden comprehensively the Act's coverage to include all companies that control banking organizations to prevent the potential abuses that Congress feared would result through the association in a holding company system of banking and commercial organizations.

The court of appeals erred in invalidating the Board's definition on the grounds that money market instruments are not the result of direct negotiations between borrower and lender. This is not the test of commercial loan—indeed commercial loan participations among banks do not involve direct negotiations (Pet. App. 55a, n.50). Moreover, a substantial portion of the transactions covered by the regulation are purchased through direct negotiations. Nor did the court below even consider the Board's finding that competitive and other pressures would inevitably create the temptation for nonbank banks to extend credit to commercial enterprises by purchasing money market instruments issued by those enterprises.

In addition, even if it is assumed that the Board's regulation represents a "complete change" in its position, the Board in adopting the definition provided the required "reasoned analysis" for rejecting earlier, more restrictive interpretations. The earlier interpretations were made in the context of institutions engaged in very limited functions and the Board had no occasion to consider the potential for evasion that could result from the widespread exploitation of the exemption for noncommercial lending institutions.

C.

In reaching its decision, the court of appeals applied an erroneous standard of review. The court failed to apply the well-established principle that a rule adopted by a federal agency pursuant to an express grant of rulemaking authority to carry out and prevent evasions of the Act must be upheld if reasonably related to the purposes of the legislation. See *Mourning* v. *Family Publications Service, Inc.*, 411 U.S. 356, 369 (1973). The court also failed to give appropriate deference to the Board's expertise in administering the Act. See *Northeast Bancorp*, slip op. 7. Instead, in direct contravention of the decisions of this Court, the court below held

that the Board's authority under the Act is limited basically to anticompetitive considerations and erroneously applied a special standard of review on the ostensible basis that, in the court's view, the Board's action would lead to a change in its own jurisdiction.

In sum, the Board's regulations are a reasonable interpretation of the elements in the bank definition in the Act, are consistent with the legislative history of the Act, and are essential to carrying out the Act's purposes. Accordingly, the Board's broad discretion to adopt these regulations and the regulations themselves should be upheld.

ARGUMENT

THE FEDERAL RESERVE BOARD PROPERLY DETERMINED THAT FOR PURPOSES OF THE DEFINITION OF BANK IN THE BANK HOLDING COMPANY ACT "DEMAND DEPOSITS" INCLUDE ALL CHECKING ACCOUNTS AND "COMMERCIAL LOANS" INCLUDE THE PURCHASE OF COMMERCIAL PAPER AND SIMILAR MONEY MARKET INSTRUMENTS.

INTRODUCTION

This case involves basic statutory policies that Congress has established to govern banking in the United States—the rules embodied in the Bank Holding Company Act aimed at separating banking from commerce and assuring local control over banking.[9] Many of the respondents in this case are companies that wish to engage in "banking" type activities without being subject to the Act. Whether they may do so turns on a narrow, but crucial, definitional question—whether the institutions acquired or operated by the respondent companies are "banks" as that term is defined in the Act—any institution that (1) accepts deposits that the depositor has a legal right to withdraw on demand ("demand deposits") and (2) engages in the business of makng commercial loans. 12 U.S.C. 1841(c). These institutions—national and state chartered commercial banks, industrial banks, and certain privately insured savings and loan associations—that seek to avoid treatment as banks under the BHC Act by not offering one of these two services, while continuing to offer functionally equivalent services, have come to be known as "nonbank banks."

Nonbank banks provide a mechanism for industrial and commercial firms to secure the benefits of affiliation with a commercial bank outside of the broad framework and prudential safeguards that Congress has established to regulate the companies that own or control banks and

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[9] Over the years the fundamental emphasis in federal banking policy in the United States has been on maintenance of local control over banking, and avoidance of large conglomerates that could result in excessive concentrations of economic and political power. *Northeast Bancorp*, slip op. 16-17; *Lewis* v. *BT Investment Managers, Inc.*, 447 U.S. at 38. This policy has had many manifestations: the failure to renew the charter of the Bank of the United States (see H. Hutchinson, *Money, Banking and the United States Economy*, 47-48 (2d ed. 1971)), the exclusive chartering for many years of all banks by the states (*ibid.*), and the tight limitations placed on interstate expansion, first on national banks, which under the original National Bank Act could not establish branches (*First National Bank in St. Louis* v. *State of Missouri*, 263 U.S. 640 (1924)) and under the McFadden Act of 1927 (12 U.S.C. 36) are limited to branches in a single state, and then on bank holding companies through the Douglas Amendment to the BHC Act. *Northeast Bancorp*, slip op. 7-12. Modern legislation implementing this policy thrust includes the Banking Act of 1933 (the Glass-Steagall Act, ch. 89, 48 Stat. 162 (1933)), which is aimed at separating commercial banking from investment banking after the inroads that banks had made during the early 1900's into this business through securities affiliates and that nonbanks had made into the banking business through trust companies. See *Investment Co. Institute* v. *Camp*, 401 U.S. 617, 629 (1971). This Act was followed by the Bank Holding Company Act of 1956, to prevent the expansion of multibank holding companies across state lines and to limit strictly their acquisitions of nonbanking businesses. Ch. 240, 70 Stat. 133. The 1970 Amendments to the 1956 Act strengthened this legislation by applying these same rules to one-bank holding companies. Pub. L. No. 91-607, 84 Stat. 1760 (1970).

thus raise the potential for significant frustration of the Act's purposes. In particular, section 4 of the Act (12 U.S.C. 1843) forbids a company from conducting both a banking business and activities unrelated to banking, in order to prevent abusive credit practices involving nonbanking affiliates,[10] to protect subsidiary banks against risky nonbanking activities financed by depositors' money,[11] and to forestall the "cartelizing [of] our economy" by preventing "the country's business firms [from] clustering about banks in holding company systems in the belief that such an affiliation would be advantageous, or perhaps even necessary to their survival." [12] In short, the BHC Act was intended to maintain banks as impartial providers of credit, to avoid conflicts of interest and undue concentration of financial resources, as well as to prevent the transmission of unregulated nonbanking risk to the banking system.

Through use of the nonbank bank device, as of April 1985, numerous industrial, securities, insurance, and retailing companies, such as intervenor Household Finance Corporation, Merrill Lynch & Co., Prudential-Bache Securities, Inc., Gulf & Western Corp., Control Data Corp.,

[10] Congress feared that a company controlling both banking and nonbanking businesses might require the customers of the bank to use services offered by the nonbanking affiliate as a condition of doing business with the bank, or might cause the subsidiary bank to make preferential or unsound loans to an affiliate engaged in an unrelated business or to discriminate in granting credit to competitors of the affiliate. S. Rep. 1095, Pt. 1, 84th Cong., 1st Sess. 5 (1955) (1956 Senate Report). See also S. Rep. 1084, 91st Cong., 2d Sess. 2-4 (1970) (1970 Senate Report); H.R. Rep. 1747, 91st Cong., 2d Sess. 11 (1970) (Statement of the Managers on the Part of the House) (1970 Conf. Report).

[11] H.R. Rep. 609, 84th Cong., 1st Sess. 4-5, 16 (1955) (1956 House Report).

[12] *Bank Holding Company Act Amendments: Hearings on H.R. 6778 Before the House Comm. on Banking and Currency*, 91st Cong., 1st Sess. 197 (1969) (*1970 House Hearings*) (testimony of Board Chairman Martin); 1970 Senate Report, *supra*, at 3.

Sears, Roebuck and Co., J.C. Penney & Co., Inc., and Travelers Corp. already control or have announced plans to acquire over 60 federally or state chartered and federally insured commercial banks. In addition, commercial enterprises such as intervenor Household Finance Corporation, General Electric Company, and Teledyne, Inc. control industrial banking organizations that are FDIC-insured and that are authorized to provide services to commercial customers.[13] Although these banks claim not to be "banks" under the BHC Act definition, their ownership by large-scale commercial, securities, insurance and industrial businesses gives rise to the same potential for preferential treatment of affiliates and their customers and unfavorable treatment of competitors, as well as for risks to the financial soundness of the bank and its depositors that led to the enactment of the BHC Act.

In addition, nonbank banks could substantially undermine the carefully circumscribed arrangements, which this Court has upheld, to carry out the policies of the Act for discount brokerage for bank holding companies (*Securities Industry Association* v. *Board of Governors*, No. 83-614 (June 28, 1984)), and for regional banking arrangements (*Northeast Bancorp* v. *Board of Governors*) as well as the prohibition on banks underwriting securities in the form of commercial paper (*Securities Industry Association* v. *Board of Governors*, No. 82-1766 (June 28, 1984)). These activities could take place freely and without limitations through nonbank banks directly, as in the case of interstate expansion, or through affiliations with parent enterprises engaged fully in investment banking and broker-dealer activities.

This potential for occurrence of the abuses Congress sought to prevent through the regulatory framework of the BHC Act is further heightened by the fact that in many cases these institutions claim to avoid coverage by the Act based on voluntary assurances that the nonbank

[13] See Appendix, *infra*, for a list of nonbank banks.

bank will forego part of the ordinary business of commercial banking. Because nonbank banks compete with institutions that offer the full range of banking services, there is a significant likelihood that in practice such assurances may not be adhered to and a nonbank bank, impelled by market pressures, will be tempted to provide indirectly all of the services of a commercial bank.[14]

In addition, under the BHC Act, bank holding companies are subject to prudential safeguards designed to ensure the financial soundness of these companies to assure that they serve as a source of strength to their subsidiary banks. 12 C.F.R. 225.4(a). These safeguards protect not only the customers and depositors of these banks, but also the resources of the federal safety net provided to the banking system by the Federal Reserve's role as lender of last resort (see, *e.g.*, 12 U.S.C. 347, 347b), and by the FDIC's insurance of deposits. 12 U.S.C. 1811. Thus, bank holding companies are required to maintain adequate capital (12 U.S.C. 3907; 12 C.F.R. Part 225, App. A), are prohibited from engaging in specific unsound corporate practices (12 C.F.R. 225.4), and are subject to examination and inspection by the Board as well as registration and periodic reporting requirements (*id.* at 225.5). In addition, the Board is authorized to undertake a broad range of enforcement actions against bank holding companies to prevent violations of law and unsound practices, to remove from office management personnel for misconduct, and to require termination of any nonbanking activity that poses a serious risk to a subsidiary bank. 12 U.S.C. 1818(b)-(f), 1844(e).

[14] Valley National Bank, Salinas, California, a nationally chartered nonbank bank affiliated with intervenor Household Finance Corp., which had claimed nonbank status by agreeing not to make commercial loans, entered into a consent cease and desist order with the Comptroller of the Currency in response to charges that the bank had in fact made commercial loans and thus had become a bank under the BHC Act, subjecting its parent corporation to the provisions of that Act. Am. Banker, May 24, 1985, p. 1, col. 3.

Moreover, banks (as defined in the BHC Act) are expressly prohibited from tying any services offered by the bank with any other services it offers or with services provided by its holding company affiliates (12 U.S.C. 1971-78); and specific regulations prohibit coercive tying by bank holding companies. 12 C.F.R. 225.4. In addition, every bank that is a holding company subsidiary must become and remain federally insured.[15] 12 U.S.C. 1842(e). Finally, insured bank subsidiaries of bank holding companies are prohibited from preferential and excessive lending to officers, directors and principal shareholders of both the holding company and its other subsidiaries. 12 U.S.C. 375b(6)(C) and (D).

The commercial and industrial firms that own nonbank banks would be subject to none of these safeguards.[16] Thus, as the Board found, nonbank banks

[15] Thrift institutions whose powers have recently been expanded so that these institutions now engage in activities that make them banks for purposes of the Act, but that are not eligible to be insured by the Federal Deposit Insurance Corporation, can meet this requirement by becoming insured by the Federal Savings and Loan Insurance Corporation, since FSLIC-insured institutions are expressly excluded from the BHC Act. 12 U.S.C. 1841(c).

[16] Indeed, the institutions insured by the Ohio Deposit Guaranty Fund, a private deposit insurer and a petitioner below, offered checking accounts and other commercial banking services without federal deposit insurance, but were recently closed by state authorities after experiencing multimillion dollar withdrawals prompted by the perceived inadequacy of the private insurance fund after one insured institution became insolvent. See, *e.g.*, N.Y. Times, Mar. 16, 1985, at 1, col. 1; Wall St. J., Mar. 14, 1985, at 8, col. 1; *id.* Mar. 12, 1985, at 3, col. 2. The closing of the ODGF-insured institutions immobilized the funds of over 500,000 depositors in institutions with assets in excess of $5.4 billion. See *Chase Manhattan Corp.*, 71 Fed. Res. Bull. 462 (1985). Some of the ODGF-insured institutions were owned by companies and thus would have been subject to the BHC Act's federal deposit insurance requirement under the Board's definitions. See C.A. Res. Opp. to Pet. Motions for Stay, 11-12.

Privately insured depository institutions in Maryland, engaged in the same activities, suffered a similar collapse shortly thereafter. N.Y. Times, May 15, 1985, at 1, col. 1; Wall St. J., May 15, 1985, at

"present the potential for a significant, haphazard, and possibly dangerous alteration of the banking structure without Congressional action on the underlying policy issues." See *U.S. Trust Corporation*, 70 Fed. Res. Bull. 371, 373 (1984).

The nonbank bank device also is at odds with another major objective of the BHC Act (embodied in the Douglas Amendment to the Act, 12 U.S.C. 1842(d)) "to retain local, community-based control over banking" by prohibiting the expansion of bank holding companies through acquisition of additional banks in other states without state consent. See *Northeast Bancorp*, slip op. 8-12; *Lewis* v. *BT Investment Managers, Inc.*, 447 U.S. at 47. Because the Act's interstate prohibitions apply only to institutions that come within the Act's bank definition, nonbank banks can be acquired in any state without regard to this policy. The serious potential for nonbank banks to undermine the Act's policy on interstate banking is evident in the fact that over 350 applications by bank holding companies to establish nationally chartered nonbank banks on an interstate basis without the approval of the host states have been approved or are pending before the Comptroller of the Currency.[17] Indeed, petitioner Dimension Financial Corporation plans to establish a network of 31 national nonbank banks, each of which would solicit the full range of deposits, in 25 different states, many of which affirmatively oppose the entry of out-of-state banking organizations (J.A. 39A).[18]

3, col. 1. In the wake of these developments, respondent Financial Institutions Assurance Corp., a private deposit insurer located in North Carolina, announced that all institutions insured by that fund would apply for federal deposit insurance. Am. Banker, May 15, 1985, at 6, col. 1. FIAC and ODGF have withdrawn as parties before this Court.

[17] Office of the Comptroller of the Currency, Summary of Nonbank Bank Applications Filed with OCC (June 21, 1985).

[18] That the proliferation of nonbank banks will deprive the states of the power to control the structure of banking within their borders is demonstrated by the fact that a number of states have

The potential for unrestrained use of the nonbank bank device to defeat the fundamental purposes of the Act has been recognized by courts that, unlike the court below, have examined the Act's definition of bank in light of the goals Congress sought to accomplish.[19]

In light of the potential for undermining the basic objectives of the Act presented by these developments, the Board acted within its express rulemaking authority to "carry out the purposes of [the BHC Act] and prevent evasions thereof" (12 U.S.C. 1844(b)),[20] in promulgating

enacted legislation prohibiting or limiting the acquisition of nonbank banks within their borders. Colo. Senate Bill 47 (Jan. 30, 1985); Conn. Gen. Stat. § 36-563 (West Supp. 1985); Fla. Stat. Ann. § 658.29(1) (West 1984); N.C. Gen. Stat. § 53-229 (Michie Supp. 1984); 1985 N.J. Sess. Law Serv. 208 (West); 1985 Tex. Sess. Law Serv. Ch. 636. Officials in other states have expressed strong opposition to the establishment of nonbank banks in their states (see Pet. App. 62a-71a).

[19] The Eleventh Circuit has held that, in order to prevent evasions of the Douglas Amendment, the Board is authorized, indeed required, to prohibit an out-of-state bank holding company from acquiring a nationally chartered nonbank bank in a state that has not consented to entry by out-of-state banking organizations, even where the nonbank bank did not engage in making commercial loans within the literal terms of the Act's definition of bank and the Board's regulation. *Florida Department of Banking and Finance* v. *Board of Governors*, 760 F.2d 1135, 1138-44 (1985).

Similarly, recognizing that the "only conceivable purpose [of nonbank banks] is to enable their parent companies to escape regulation under the BHC [Act]," a federal district court has preliminarily enjoined the Comptroller of the Currency from issuing final charters for nonbank banks, expressing serious doubts that the National Bank Act authorizes the chartering of such institutions. *Independent Bankers Ass'n of America* v. *Conover*, No. 84-1403-CIV-J-12 (M.D. Fla. Feb. 15, 1985), slip op. 39 (order granting preliminary injunction). As a result of this injunction, the Board returned to applicant bank holding companies all applications to acquire national nonbank banks across state lines.

[20] This authority enables the Board, in construing the Act's definition of bank, to disregard the form of transactions and look to their substance in order to prevent a clear evasion of the purposes of the Act (*Wilshire Oil Co.* v. *Board of Governors*, 668 F.2d

regulations clarifying the two elements of the definition of the term "bank" in order to identify situations where nonbank banks are evading the purposes of the legislation. As we demonstrate below, the Board properly defined "deposits that the depositor has a legal right to withdraw on demand" for purposes of the definition of bank to include NOW accounts. 12 C.F.R. 225.2(a)(1)(A). The Board also properly defined "commercial loans" for purposes of the bank definition to include the purchase of money market instruments, such as commercial paper, which constitute the indirect provision of credit to commercial and industrial enterprises. 12 C.F.R. 225.2(a)(1)(B).

A. Consistent With the Terms and Legislative Intent of the BHC Act and in Order to Prevent Evasions of the Purposes of That Act, the Board Acted Within Its Discretion Under the Statute in Determining That NOW Accounts Are Demand Deposits for Purposes of the Definition of Bank.

The Board acted in accordance with the terms and legislative intent of the Act and within the Board's express authority to carry out the purposes and prevent evasions of the BHC Act in defining "deposits that the depositor has a legal right to withdraw on demand" as used in the Act's definition of bank to include NOW accounts.

1. NOW accounts operationally are indistinguishable from conventional demand deposit checking accounts because they are freely withdrawable by check on demand and because the notice of withdrawal requirement is not, and cannot practicably be, exercised (Pet. App. 38a-40a).[21] Drafts drawn on NOW accounts are cleared and

at 739) and in order to "insur[e] compliance with Congress' goals." *Florida Department of Banking and Finance*, 760 F.2d at 1144.

[21] Like a conventional checking account, the NOW account depositor makes withdrawals by means of a negotiable draft given to a third party payee to effect a transfer of funds to the third party from the depositor. The payee of the NOW draft typically deposits

collected through the Federal Reserve's check collection facilities as demand items, exactly like conventional checks, and are accepted by merchants and others on the basis that they are demand items (Pet. App. 38a). NOW accounts, moreover, are uniformly advertised by depository institutions as "checking accounts," with little if any reference to the theoretical notice of withdrawal requirement (*Id.* at 39a). Empirical evidence shows that, because of the operational similarity of NOW accounts to conventional demand deposits, both types of accounts are used by depositors for precisely the same purposes—to pay bills and perform other financial transactions.[22]

The legislative history of the BHC Act provides compelling support for the Board's reading of the statutory "legal right to withdraw on demand" language in the bank definition as covering NOW accounts. The history shows that this language was intended to create a functional test for delineating the kind of deposits

it in the payee's bank for collection from the drawee institution. The drawee institution then charges the depositor's NOW account to pay the draft. See, *e.g.*, *New York State Bankers Ass'n* v. *Albright*, 38 N.Y. 2d 430, 381 N.Y.S. 2d 18, 343 N.E. 2d 735 (1975); Kaplan, *Federal Legislative and Regulatory Treatment of NOW Accounts*, 91 Banking L.J. 439, 440 (1974) ("NOW accounts permit money transfers to third parties in much the same manner as conventional checking accounts").

The United States Court of Appeals for the District of Columbia has recognized the functional equivalence of demand deposits and a NOW account-like arrangement (an automatic transfer arrangement between a notice of withdrawal account and a zero-balance checking account). *American Bankers Ass'n* v. *Connell*, 686 F.2d 953, 954 (D.C. Cir.), cert. denied, 444 U.S. 920 (1979). See *Otero Savings & Loan Ass'n* v. *Federal Home Loan Bank Board*, 665 F.2d 279 (10th Cir. 1981) (similar treatment accorded identical type arrangement).

[22] *E.g.*, Hoffman and Herman, *NOW Accounts in New England*, in American Bankers Association, Studies on the Payment of Interest on Checking Accounts 31 (1976) ("[A] large number of depositors are using their NOW account as their main transaction account"); Simpson and Williams, *Recent Revisions in the Money Stock*, 67 Fed. Res. Bull. 539, 542 (1981) (70 to 80 percent of funds deposited in new-type checking accounts, *e.g.*, NOW accounts, opened in early 1981 were shifted from conventional demand deposits).

covered by the Act and that the determinative function is the ability routinely to make withdrawals by check. Thus, Congress selected the "legal right to withdraw" terminology not because Congress believed the legal rights of depositors to be crucial, but because Congress wished to cover "checking accounts" and used the terminology that then designated the only kind of checking account in existence.[23] See *Wilshire Oil Co.* v. *Board of Governors*, 668 F.2d at 737.

As originally enacted, the BHC Act defined a bank broadly to include "any national banking association or any State bank, or savings bank, or trust company." Bank Holding Company Act of 1956, ch. 240, § 2, 70 Stat. 133, 12 U.S.C. 1841. In response to inquiries as to whether state chartered industrial banks were "State banks" for purposes of this definition, the Board ruled that such an institution would be covered if it either "[1] accept[ed] deposits subject to check or [2] otherwise accept[ed] funds from the public that [were], in actual practice, repaid on demand." 49 Fed. Res. Bull. 166 (1963).[24] This interpretation covered as banks institutions that received two separate classes of deposits distinguished, not by the existence of a notice of withdrawal requirement, but functionally by the method by which withdrawals could be made.

In 1966, representatives of the industrial banking industry subsequently requested Congress to exclude these institutions from coverage under the definition of bank.[25]

[23] NOW accounts did not exist until the early 1970's when they were offered by nonfederally insured thrift institutions in New England. Congress first authorized federally insured banks to offer NOW accounts in New England in 1973 and nationwide in 1980. See p. 36, *infra*. Prior to that time, federally insured banks were prohibited from offering NOW accounts by the federal ban on the payment of interest on demand deposits enacted in 1933. 12 U.S.C. 371a and 1828(g)(1).

[24] See also 51 Fed. Res. Bull. 1539-40 (1965).

[25] Historically, industrial banks (also referred to as Morris Plan banks or industrial loan companies) were consumer-oriented institutions that provided installment credit to consumers and accepted passbook savings deposits and sold investment certificates (similar to bank certificates of deposit). These institutions were called "industrial" banks because they served industrial workers and other similar customers who at the time often could not obtain credit from commercial banks. See, *e.g.*, H. Jennings, *The Consumer in Commercial Banking* 13 (1939); R. Saulnier, *Industrial Banking Companies and Their Credit Practices* 12 (1940).

As a basis for exemption, they expressly advised Congress that industrial banking companies "[did] not accept checking accounts," although they did accept deposits "in passbook or certificate form." *Amend the Bank Holding Company Act of 1956: Hearings on S. 2353, S. 2418 and H.R. 7371 Before a Subcomm. of the Senate Comm. on Banking and Currency*, 89th Cong., 2d Sess. 157-158 (1966) (*1966 Senate Hearings*).[26] The Board endorsed the trade association's request, proposing that the definition of bank be amended to cover only "an institution that receives deposits payable on demand * * * (*i.e.*, banks that offer checking accounts)" (*Id.* at 447). The Board stated that this proposal would exclude industrial banks and other institutions "that accept funds from the public that are paid on demand" (*ibid.*). This proposal was plainly meant to continue coverage of the deposits in the first category described in the Board's 1963 interpretation (deposits subject to check) and to exclude from coverage deposits in the second category (passbook and statement savings accounts which were in practice paid on demand but which were not withdrawable by check).

The Board's proposal was in substance enacted. Pub. L. No. 89-485, § 3, 80 Stat. 236, 12 U.S.C. 1841(c). Although the language in the bill reported by the Senate Banking Committee (and later enacted) referred to de-

[26] Although the accounts offered by industrial banking organizations were subject to a prior notice requirement, the institutions permitted withdrawals from these accounts on demand and thus could have fallen within the second prong of the Board's 1963 interpretation of "bank" (*ibid.*).

posits in terms of a legal right to withdraw on demand, the Committee's report explaining this language describes it in functional terms as covering deposits "payable on demand (checking accounts)", precisely the terminology the Board had proposed.[27] S. Rep. 1179, 89th Cong., 2d Sess. 7 (1966). The Report emphasized that receipt of checking accounts was "the commonly accepted test of whether an institution is a commercial bank" and captioned its discussion of the amendment as concerning the "[e]xclusion of institutions that do not accept checking accounts" (*ibid.*) (emphasis omitted). According to the sponsor of the amendment, the new definition of bank would exclude industrial banks and similar institutions that "do not accept demand deposits subject to check," *i.e.*, "deposits in the form ordinarily received by commercial banks." 112 Cong. Rec. 12385-86 (1966) (remarks of Sen. Robertson). Thus, the legislative history is clear that the "legal right to withdraw on demand" language in the bank definition was intended by Congress to cover deposits withdrawable by check and paid on demand—a definition that squarely encompasses NOW accounts.

Moreover, at the time the demand deposit proviso was added to the Act in 1966, notice of withdrawal accounts that could be checked against (identical to what later would be called NOW accounts) had been treated as demand deposits for bank regulatory purposes for over 50 years and on this basis had been prohibited for federally regulated banks since 1933. 21 Fed. Res. Bull. 863 (1935). See 26 Fed. Reg. 12031 (1961). This was done

[27] Respondents have cited no evidence (nor has any been uncovered) even suggesting that the substitution of the "legal right to withdraw" terminology was intended to effect a substantive change in meaning. Indeed, it would make little sense for Congress, with no explanation or discussion, to have abandoned a recognized test for coverage based on function (method of withdrawal) and replace it with a purely technical test that has no functional significance whatsoever.

in recognition of the fact that "the practice * * * of drawing checks on savings deposits" converts such notice of withdrawal accounts into "ordinary checking accounts and evade[s] the statutory prohibition against payment of interest on demand deposits." 21 Fed. Res. Bull. at 792.[28]

The court of appeals' entire analysis of this history is premised on the unsupportable assumption that the addition of the demand deposit test in 1966 completely overturned the Board's 1963 interpretation of the scope of the definition of bank in the original Act. *First Bancorporation*, 728 F.2d at 437. This assumption ignores the fact that the 1963 interpretation covered two distinct classes of deposits: checking accounts and savings deposits in practice repaid on demand. As shown above, the demand deposit amendment clearly meant to continue to cover institutions that offered checking accounts.[29]

2. Apart from the legislative history, a NOW account depositor, as the Board expressly found (*First Bancorporation*, 68 Fed. Res. Bull. at 253), does in fact have a legal right to withdraw funds from the account on demand unless and until the depository institution actu-

[28] Similarly, the Board earlier had recognized that deposits subject to a notice of withdrawal requirement but that "ordinarily may be checked upon" were demand deposits for purposes of the provisions of the Federal Reserve Act of 1913 (38 Stat. 270) requiring member banks of the Federal Reserve System to maintain reserves against various kinds of deposits. 1 Fed. Res. Bull. 38-39 (1915). Accord, *id.* at 73; 9 Fed. Res. Bull. 677 (1923); 13 Fed. Res. Bull. 609 (1927).

[29] The court of appeals' reliance on legislative understanding that the "demand deposit" test would exclude industrial banks (*First Bancorporation*, 728 F.2d at 437) is misplaced. As Congress clearly was aware, at the time of the demand deposit amendment, industrial banks did not accept deposits subject to check. 112 Cong. Rec. 12385 (1966) (remarks of Sen. Robertson); *1966 Senate Hearings*, *supra*, at 157. Today, however, as the respondent industrial banking organizations admit, such institutions are authorized to, and do, accept checking accounts in the form of NOW accounts.

ally requires prior notice of withdrawal.[30] Prior notice of withdrawal can never be practicably invoked with regard to NOW accounts, because withdrawals are made from such accounts by checks given directly to third party payees and invoking the prior notice requirement would cause serious damage to the reputation of the institution and loss of customer good will.[31] Indeed, requiring prior notice of withdrawal would defeat the very purpose of NOW accounts as a substitute for demand checking accounts.[32]

The Board is not aware of a single instance, and respondents have cited none, in which the notice of withdrawal requirement has been invoked on NOW accounts (see Pet. App. 40a). Indeed, during the recent crises in Ohio and Maryland involving privately insured depository institutions offering NOW accounts, there is no evidence that any such institution invoked the prior notice of withdrawal requirement, even though many

[30] Under federal law, the notice requirement, if invoked, must be required for all similar accounts at the institution, thereby eliminating the ability to selectively require notice on NOW accounts. See 12 C.F.R. 217.5(a) and 329.5(a).

[31] By requiring prior notice of withdrawal with respect to a NOW account, the depository institution would necessarily be required to refuse or delay payment to the payee of the NOW draft, undoubtedly a bona fide holder of a negotiable instrument, such as a merchant who typically has given value for the draft and who is not necessarily a customer of the depository institution. Payees would no longer accept drafts drawn on that institution and depositors, needing a more reliable method of effecting payments, would ultimately withdraw their NOW account funds.

[32] Under the Board's regulation, holders of traditional passbook or statement savings accounts or of similar types of deposits, which usually also are repaid in practice on demand, do not have a legal right to withdraw on demand for purposes of the definition of bank. Withdrawals from these types of deposits cannot be made by checks given directly to third parties, and thus the prior notice of withdrawal can practicably be required with respect to such accounts and in fact on occasion has actually been required. See Am. Banker, June 22, 1976, p. 1, col. 2.

institutions were threatened by massive withdrawals from such accounts that eventually required the closing of the institutions by state authorities. In recognition that notice is unlikely ever to be required on NOW accounts, the Federal Reserve treats NOW accounts as components of the M1 money stock measure, the same treatment given to currency and demand deposits.[33]

Thus, the very nature and purpose of NOW accounts underscores the fact that the depositor has a legal right to withdraw on demand from such accounts, until prior notice of withdrawal is actually required. Accordingly, NOW accounts fall within the terms of the "legal right to withdraw" language in the bank definition.

3. This Court has repeatedly stated that the language of a statute must be read with a view to the "policy of the legislation as a whole" and cannot be read to negate the plain purpose of the legislation.[34] This principle is particularly applicable in this case in view of the express congressional mandate to the Board to take necessary action to carry out the purposes and prevent evasions of the Act.[35] As the Board found, and the record in this case demonstrates, NOW accounts are the functional equivalent of demand deposits and the failure to recognize this equivalency would open an avenue for evasion of the BHC Act that would negate to a substantial extent the Act's plain purposes.

[33] See, *e.g.*, 71 Fed. Res. Bull. A3 (July 1985); H.R. Rep. 263, 96th Cong., 1st Sess. 4 (1979) (NOW accounts "form the basis, along with Federal Reserve currency, of our country's medium of exchange.").

[34] *United States* v. *American Trucking Ass'ns, Inc.*, 310 U.S. 534, 542-43 (1940). See *Bob Jones University* v. *United States*, 461 U.S. 574, 586 (1983); *United Steelworkers of America* v. *Weber*, 443 U.S. 193, 201-02 (1979); *Chapman* v. *Houston Welfare Rights Organization*, 441 U.S. 600, 608 (1979).

[35] See *Mourning* v. *Family Publications Service, Inc.*, 411 U.S. at 371; *Gemsco, Inc.* v. *Walling*, 324 U.S. 244, 255 (1945); *Wilshire Oil Co.* v. *Board of Governors*, 668 F.2d at 738-39.

If NOW accounts are not treated as demand deposits, a nonbanking company could become affiliated with a federally or state chartered bank that engages in activities functionally identical to those of institutions the Act otherwise covers without being subject to the regulatory framework Congress established for such affiliations. As a result, nonbanking companies would escape the prudential and other provisions of the Act designed to prevent the abuses that Congress determined were likely to arise from the commingling of banking and commerce.

In addition, the ability of bank holding companies, as well as nonbanking commercial enterprises, to own nonbank banks with NOW account and commercial lending powers would result in multi-state, indeed nationwide, networks of nonbank banks and *de facto* interstate banking without the consent of any state, as required by the interstate provisions of the Act, or the Congress. Such a result is in direct conflict with the provisions of the Act and would nullify the Act's purpose to maintain local control of banking expansion across state lines. See *Northeast Bancorp*, slip op. 12.

In view of the functional equivalency of NOW accounts and demand deposits and the potential for nonbank banks to undermine the purposes of the BHC Act, the Board properly exercised its authority to prevent evasions of the Act by adopting a reading of the bank definition that would include NOW accounts.

Contrary to the opinion below (*First Bancorporation*, 728 F.2d at 436), there are no differences in substance between NOW accounts and conventional demand deposits that are material to the purposes of the BHC Act. Although, unlike conventional demand deposits, NOW accounts are not generally available to corporate depositors,[36] this factor at best serves merely to limit, but not prevent completely, the evasion of the Act that results

[36] 12 U.S.C. 1832(a)(2). Some businesses, *i.e.*, sole proprietorships, may have NOW accounts. 12 C.F.R. 217.157(b).

from the operational identity between the two types of accounts. The fact that NOW accounts pay interest enhances their ability to be used as a substitute for conventional demand deposits. In any event, the differences between NOW and conventional demand accounts regarding availability and interest do not distinguish the actual functions of nonbank banks that accept NOW accounts from those of the many banks that undisputedly are covered by the Act, and which do not conduct a significant amount of corporate business.[37]

Congress itself has recognized that NOW accounts are the functional equivalent of conventional demand deposits (notwithstanding the prior notice requirement) and must be treated as such in order to forestall evasion of legal requirements relating to demand deposits.

4. In the early 1970's, state chartered thrift institutions located in Massachusetts and New Hampshire, which were not federally insured and hence not subject to the federal ban on paying interest on demand deposits, began permitting withdrawals from savings accounts to be made by check, referring to this arrangement as a "NOW account." [38] Congress responded by enacting legislation that effectively banned the offering of NOW accounts by all depository institutions by prohibiting withdrawals from interest-bearing accounts by check or other negotiable instrument, except in Massachusetts and New Hampshire, where NOW accounts were authorized on an experimental basis. Pub. L. No. 93-100, § 2, 87 Stat. 342,

[37] Based on data compiled by the Board in 1984, at about 1,900 commercial banks (more than 10 percent of the total number of banks nationwide), the total amount of conventional demand deposits held by the bank was less than 10 percent of the bank's assets. According to statistics maintained by the Board, corporate checking accounts typically constitute about fifty percent of total demand deposits.

[38] See Kaplan, *Federal Legislative and Regulatory Treatment of NOW Accounts*, *supra*.

12 U.S.C. 1832. The legislation was motivated by congressional awareness that:

> Failure to ban "NOW" accounts infringes on a 40-year old statutory prohibition on the payment of interest on checking accounts.

119 Cong. Rec. 16071 (1973) (remarks of Sen. Brock).[39]

In 1980, Congress authorized NOW accounts on a nationwide basis.[40] Pub. L. No. 96-221, § 303, 94 Stat. 146, 12 U.S.C. 1832(a). In enacting this authorization, Congress was clearly aware that permitting NOW accounts in reality sanctioned the payment of interest on demand deposits, because NOW accounts "are the functional equivalent of interest bearing checking accounts." S. Rep. 368, 96th Cong., 1st Sess. 5 (1979). Indeed, the sponsor of the NOW account legislation expressly recognized that the authorization of NOW accounts, which he characterized as interest-bearing accounts "subject to withdrawal on demand," overrides the historic prohibition against the payment of interest on demand deposits. 125 Cong. Rec. 23793 (1980) (remarks of Rep. St Germain).

The 1980 legislation authorizing NOW accounts nationwide also required that depository institutions must maintain the same level of reserves with respect to all transaction accounts, which are defined by statute to include both NOW accounts and conventional demand deposits.[41] 12 U.S.C. 461(b)(1)(C) and (2)(A). Thus,

[39] See also *id.* at 15002 (remarks of Rep. Patman) (characterizing NOW accounts as "demand deposits"); *id.* at 15005 (remarks of Rep. Johnson) (characterizing NOW accounts as "checking accounts"); *id.* at 16486 (remarks of Sen. Proxmire) (characterizing NOW accounts as "demand deposits").

[40] Between 1973 and 1980, Congress also permitted NOW accounts on a statewide basis in Connecticut, Maine, Rhode Island, and Vermont (Pub. L. No. 94-222, 90 Stat. 197), New York (Pub. L. No. 95-630, 92 Stat. 3712), and New Jersey (Pub. L. No. 96-161, 93 Stat. 1235).

[41] Because Congress by statutory directive has sanctioned the payment of interest on NOW accounts and required maintenance

Congress again affirmed the necessity of treating NOW accounts as demand deposits in order to prevent evasion of legal requirements applicable to demand deposits.

5. The only other court of appeals to interpret the demand deposit test of bank in section 2(c) of the Act completely rejected the formalistic approach adopted by the court below and approved the functional analysis followed by the Board in this case as necessary and appropriate to carry out the intent of the Act and prevent evasions thereof. In *Wilshire Oil Co.* v. *Board of Governors*, a commercial bank attempted to escape coverage as a bank for purposes of the Act by imposing a prior notice of withdrawal requirement on its conventional demand deposits, and advised its customers that it had no intention of exercising that right. 668 F.2d at 733-34. The Third Circuit upheld the Board's determination that, notwithstanding the retention of a notice of withdrawal requirement on its deposits, the institution remained a bank for purposes of the Act (*id.* at 736-40). The *Wilshire* court concluded (as the Board has here) that in enacting the "legal right to withdraw on demand" terminology Congress intended the functional nature of deposits to be the decisive factor because "Congress was not as concerned with the precise legal right of a bank's depositors as it was with the practical effect of the Act on commercial lending practices" (*id.* at 737). The court held that the Board was authorized under the Act to penetrate the form and look to the substance of the transaction and to conclude that the reservation of a prior notice of withdrawal requirement had no practical effect on the operations of the bank involved and did not

of the same level of reserves with respect to NOW accounts as are maintained on conventional demand deposits, the manner in which such accounts are currently classified for purposes of the Board's regulations governing reserve requirements and the payment of interest on demand deposits is no longer significant. Such classifications are clearly overshadowed by Congress' statutory determination that NOW accounts and conventional demand deposits must be treated interchangeably.

remove the institution from coverage under the definition of bank in the Act.[42] 668 F.2d at 740.

Given that NOW accounts are checking accounts operationally indistinguishable from conventional demand checking accounts, that Congress intended the Act to cover institutions that offer checking accounts, and that substantial evasion of the Act would otherwise result, the Board clearly acted properly and in accord with the terms and purposes of the Act in including NOW accounts as demand deposits for purposes of the Act's definition of bank.

B. Consistent With the Statutory Language and Its Legislative History and in Order to Prevent Evasions of the Act the Board Acted Within Its Discretion Under the Act in Defining Commercial Loans for Purposes of the Definition of Bank to Include the Purchase of Commercial Paper and Other Money Market Transactions.

The Board defined the term "commercial loans" for purposes of the BHC Act's definition of bank in accordance with its longstanding interpretation of the term as "any loan other than a loan to an individual for personal, family, household, or charitable purposes." 12 C.F.R. 225.2(a)(1)(B). The Board's regulation includes within the scope of this definition the purchase of money market instruments, such as commercial paper, bankers' acceptances, and certificates of deposit, the purchase of retail installment loans, the sale of federal funds, and the making of broker call loans because, as the Board found, these transactions constitute the direct or indirect extension of credit to a business organization (*ibid.*). This definition is consistent with the terms and legislative intent of the Act and clearly constitutes a reasonable

[42] As explained above, pp. 34-35, *supra*, the differences in substance between the type of transaction account at issue in *Wilshire* and the NOW accounts covered by the Board's regulation are not significant, viewed in terms of the broad purposes of the Act.

exercise of the Board's authority under the Act to adopt rules to carry out the purposes of the Act.

1. The BHC Act does not define the term "commercial loans" for purposes of the statutory definition of bank. The purchase of money market instruments and other transactions defined by the Board as commercial loans for purposes of the definition of bank clearly fall within a permissible construction of that term. Indeed, neither the court of appeals nor respondents have challenged the Board's findings as to the economic nature of the relevant money market instruments.

It is uncontested that each of the transactions covered by the Board's definition establishes a debtor-creditor relationship and results in the extension of credit and that the beneficiaries of these transactions are not individuals, but rather corporations that utilize the funds for business purposes. Moreover, as the Board found (Pet. App. 48a-55a), these transactions also fall within this Court's definition of the term "commercial loan" as short-term transactions in which funds are provided to businesses, typically for inventory or working capital needs. See *United States* v. *Connecticut National Bank*, 418 U.S. 656, 665 (1974).

For example, as the Board stated (Pet. App. 49a), commercial paper refers to "a prime quality, short-term promissory note establishing a debtor-creditor relationship between a lender and * * * large, financially strong corporate borrowers [needing] funds for seasonal or working capital purposes."[43] This finding accords fully with this Court's recent observation that "the authority to discount commercial paper" places "banks in their traditional role as a prudent lender," and that banks purchase commercial paper for their own account as part

[43] See generally Hurley, *The Commercial Paper Market*, 63 Fed. Res. Bull. 525, 527-28 (1977); M. Stigum, *The Money Market* 625-48 (rev. ed. 1983) (Stigum).

of "the process of extending credit." *Securities Industry Association* v. *Board of Governors*, No. 82-1766, slip op. 20, 21 n.11. Indeed, when the commercial lending test was added, commercial paper purchased by a bank in the open market was reported for regulatory purposes in the bank's published balance sheet in the category of "commercial and industrial loans." [44]

Based on the undisputed economic characteristics of the instruments, the Board also reasonably found that a bank's purchase of certificates of deposit [45] and bankers' acceptances [46] and sale of federal funds [47] each represents a short-term extension of credit to a business enterprise in order to finance inventory or for other working capital purposes. There is no reasonable dispute that, in the case of interbank money market transactions, funds are clearly being extended to a commercial enterprise, which uses the proceeds to make loans—the inventory of a bank.[48]

Similarly, it cannot be reasonably disputed that a bank's purchase of retail installment paper from a merchant involves a clear extension of credit to finance the day-to-day commercial operations of the merchant and that broker call loans are demand loans to finance operations of securities brokers (Pet. App. 59a).

2.a. The relevant legislative history demonstrates clearly that the exemption from the Act's coverage for institutions that do not engage "in the business of making commercial loans" was a technical amendment to the Act designed to create a narrowly circumscribed exclusion from the Act's coverage. The provision was introduced by Senator Brooke without any discussion or comment (116 Cong. Rec. 14818-22 (1970)) and was added in committee to the bill eventually enacted. See 116 Cong. Rec. 42426 (1970) (remarks of Sen. Sparkman); 1970 Senate Report, *supra*, at 24. The Board did not object to the amendment, explicitly recognizing "the very limited application of this amendment, * * * possibly affecting only one institution." *One-Bank Holding Company Legislation of 1970: Hearings on S. 1052 and Related Bills Before the Senate Comm. on Banking and Currency*, 91st Cong., 2d Sess. 137 (1970). Congress subsequently was advised that "virtually the only bank which does no commercial lending * * * is the Boston Safe Deposit & Trust Co., a subsidiary of the Boston Co." 116 Cong. Rec. 25848 (1970) (remarks of Rep. Gonzalez). The statement of the majority of the House

[44] See C. A. Pet. Joint Reply Br. App. 1793. See also Pet. App. 50a (opinion letters of the Comptroller of the Currency that commercial paper is nothing but a "loan to industrial corporations"). Thus, the court below was clearly in error in asserting that the term commercial loans "as used in the banking business when the Act was adopted did not include the purchase of money market [instruments]" (*id.* at 11a-12a).

[45] A certificate of deposit (CD) is an instrument evidencing the obligation of a bank to repay a sum of money at a specified time and, generally, at a fixed rate of interest. Banks issue large denomination CDs ($1 million or more) in the money market to finance working capital needs—to fund short-term loans by the bank (Pet. App. 50a-52a). Stigum, *supra*, at 35-36, 525-38; C. Henning, W. Pigott, and R. Scott, *Financial Markets and the Economy*, 293-95 (3d ed. 1981) (*Financial Markets and the Economy*).

[46] A bankers' acceptance is an order drawn on a bank to pay a specified sum on a specified date (usually several months in the future) that the drawee bank has accepted, *i.e.*, agreed to pay at maturity. Bankers' acceptances are used to finance specific, identifiable commercial transactions by the account party (the business on whose behalf the draft is accepted), usually the import or export of goods (Pet. App. 53a-55a). *See* Stigum, *supra*, at 39-40, 602-11; H. Harfield, *Bank Credits and Acceptances*, 116-53 (5th ed. 1974).

[47] The "sale" of federal funds is the loan (usually overnight) of excess funds on deposit in a depository institution's reserve account with the Federal Reserve to another depository institution (Pet. App. 53a). See Stigum, *supra*, at 33-34; *Financial Markets and the Economy*, *supra*, at 287-90.

[48] A bank is clearly a "commercial" enterprise. See *United States* v. *Philadelphia Nat'l Bank*, 374 U.S. 321, 355-57 (1963) (commercial banking is a "line of commerce" for purposes of the Clayton Act).

conferees on the legislation directed that "[t]he Board should interpret th[is] exemption[] as narrowly as possible in order that all bank holding companies which should be covered under the Act in order to protect the public interest will, in fact, be covered." 1970 Conf. Report, *supra*, at 23.

b. That Congress meant the commercial loan exception to be narrowly construed is also graphically shown by the other amendments to the Act adopted in 1970, which substantially reaffirmed and strengthened the regulatory framework of the Act. The 1970 Amendments extended the coverage of the Act to previously exempt companies, in particular to those companies controlling only a single bank.[49] Pub. L. No. 91-607, § 101(a), 84 Stat. 1760, 12 U.S.C. 1841(a)(1).[50] The 1970 Amendments also sought to protect the customers of banking institutions by enacting a broad regulatory framework designed to prevent the anticompetitive and unfair tying of bank services. Pub. L. No. 91-607, § 106, 84 Stat. 1766, 12 U.S.C. 1971-78. Since these anti-tying provisions apply only to banks as defined for purposes of the BHC Act (12 U.S.C. 1971), it is highly implausible that the exemption for non-commercial lending institutions was meant to exclude a significant number of banking institutions. Indeed, during consideration of the 1970 Amendments, Congress specifically rejected an exemption for small banks.[51]

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[49] The 1970 legislation also deleted the exemptions for partnerships that controlled a bank and for bank trust departments holding substantial blocks of stock of a bank with sole power to vote the stock and authorized the Board to find that a company controls a bank (and thus becomes subject to the Act) by exercising a controlling influence over the policies of the bank. 1970 Conf. Report, *supra*, at 12.

[50] Congress's action to cover companies owning a single bank was motivated by the formation during the previous several years of a large number of one-bank holding companies that were free to engage in activities totally unrelated to banking. See 1970 Conf. Report, *supra*, at 11; 1970 Senate Report, *supra*, at 2-4.

[51] 1970 Conf. Report, *supra*, at 23.

In addition, the lack of extensive legislative discussion of the exemption for institutions that do not make commercial loans also shows that the exemption was not intended to sanction any significant departure from the basic objectives of the original Act, which the 1970 Amendments strengthened and reaffirmed. As the Board noted, it is inconsistent with this legislative history to conclude that Congress, almost without debate, intended that the business of making commercial loans, one of the hallmarks of a bank under the Act, be given a narrow reading that would create a new class of depository institution that could be acquired by securities, insurance, retail and other nonbanking companies or on an interstate basis by bank holding companies, without regard for the policies of the states involved (Pet. App. 25a-26a).

c. The court of appeals' analysis of the legislative history is premised on the completely unsupported assumption that both Congress and the Board knew when the 1970 Amendments were being considered that the supposed beneficiary of the exemption, the Boston Safe Deposit & Trust Co., was engaging in purchasing the kinds of money market instruments the Board has now defined as commercial loans (Pet. App. 9a-11a). There is, however, not a scrap of evidence in the legislative history even suggesting that this was the case.[52] If anything, Congress was aware that Boston Safe historically offered primarily trust and investment advisory services.[53]

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[52] The court of appeals is in error in summarily stating that the Board advised the Senate Committee that purchases of money market instruments by Boston Safe were not considered as commercial loans (Pet. App. 11a). The Board's comments to the committee clearly contained no such statement.

[53] In 1966, the Boston Company, Boston Safe's parent, unsuccessfully requested a separate amendment exempting it from coverage of the Act on the grounds that Boston Safe was "primarily engaged in the fields of investment and property management and in the other fiduciary services usually identified with the personal trust business." *1966 Senate Hearings*, *supra*, at 732. Nothing in this

Moreover, since, as explained below, a bank's purchase of commercial paper is uniformly understood (in 1970 and today) as the making of a commercial loan by the bank (see *Securities Industry Association*, No. 82-1766, slip op. 20, 21 n.11), it is highly unlikely that Congress actually was aware that (as has subsequently become clear) in 1970 Boston Safe did in fact purchase money market instruments, in particular, commercial paper (J.A. 93A-95A).

3.a. In reaching its decision, the court of appeals also found no evidence of the abuses contemplated by the BHC Act by those purchasing money market instruments, noting that money market transactions take place in the open market (Pet. App. 12a). However, there is no support in the statute or its history for the view that commercial loans must be the result of direct negotiations between borrower and lender.[54] Moreover, the court below flatly ignored the Board's uncontested finding that "a substantial portion of the transactions in all of these instruments occurs through direct negotiations between lenders and borrowers" [55] (*id.* at 55a). Nor did the court even consider the Board's finding that implicit agreements by nonbank banks could result in precisely the type of preferential credit practices the Act was designed to prevent (*id.* at 28a). For example, a nonbank bank might extend short-term funds to another bank or lending institution by purchasing money market instruments issued by the other institution on the implied understanding that the other institution would look favorably on loan requests by the nonbank bank's commercial or industrial affiliates or by customers of the nonbank bank needing conventional commercial loans. The finding of the court below also ignores the fact that the statute was enacted to foreclose the potential for abusive practices. See 1970 Senate Report, *supra*, at 4 (Act extended to one-bank holding companies "to prevent possible future problems rather than to solve existing ones").

request or elsewhere in the legislative history describes or alludes to Boston Safe's money market activities.

[54] For example, participating banks in a loan syndication or participation typically have no direct negotiations with the borrower, which deals only with the lead bank, yet these banks are uniformly understood to be making commercial loans. See, *e.g.*, *Union Planters Nat'l Bank* v. *Commercial Credit Business Loans, Inc.*, 651 F.2d 1174, 1179-85 (6th Cir.), cert. denied, 454 U.S. 1121 (1981).

[55] For example, as of January 1985, almost one-half of the total volume of outstanding commercial paper was directly placed by the borrower. 71 Fed. Res. Bull. A23 (May 1985). Most bank money market CDs are sold directly by banks to lenders. Stigum, *supra*, at 36. Quite clearly, broker call loans and the purchase of retail installment paper involve direct negotiations between lender and borrower.

The court of appeals also failed to give heed to the Board's explicit finding on the likelihood of serious enforcement problems posed by the purchase of short-term credit obligations by nonbank banks (Pet. App. 28a). It is evident that an institution that has voluntarily forsaken commercial lending to escape coverage under the Act, but that vigorously markets an otherwise full range of deposit and lending services (including demand deposits to corporate customers) in direct competition with full service banks will be subject to compelling competitive pressure to provide in practice, directly or indirectly, all the services of a commercial bank, regardless of voluntary assurances to the contrary. Thus, a bank that nominally agrees to cease making directly negotiated commercial loans to businesses in order to avoid bank status would be subject to significant competitive and profit-oriented incentives to continue to supply short-term funds to businesses simply by purchasing the business's money market obligations (see pp. 21-22 above).

The fact, cited by the court below, that the commercial loan definition would assertedly cause "extensive changes" by some financial institutions (Pet. App. 5a) affords no grounds for overturning that definition. These institutions (privately-insured savings and loan associations and industrial banks) would be affected by the Board's

definition only if they elect voluntarily to exercise recently conferred, non-traditional powers that make these institutions the functional equivalent of a traditional commercial bank.[56] In tacit recognition that the newly expanded activities of savings and loan associations enable them to act functionally like banks, Congress, in 1982, expressly exempted federally insured savings and loan associations from coverage by the BHC Act. Pub. L. No. 97-320, § 333, 96 Stat. 1504, 12 U.S.C. 1841(c). Pointedly, however, this exemption by its terms did not extend to associations that are privately insured. The inference is plain that Congress intended these institutions to be banks under the BHC Act if they implemented newly authorized, expanded powers.

b. The court of appeals also found error in the Board's regulatory definition of commercial loans largely because the current definition represented what the court perceived as a "complete change" from earlier Board interpretations (Pet. App. 8a). This finding clearly runs afoul of the established teaching of this Court.

It is well established that an agency does not act unlawfully merely because it alters prior views on the meaning of a statute it is charged with administering. This Court repeatedly has "recognize[d] that 'regulatory agencies do not establish rules of conduct to last forever,' *American Trucking Assns., Inc.* v. *Atchison, T. & S.F. R. Co.*, 387 U.S. 397, 416 (1967), and that an agency must be given ample latitude to 'adapt their rules and policies to the demands of changing circumstances.' *Permian Basin Area Rate Cases*, 390 U.S. 747, 784 (1968)."

[56] During the 1980's, the powers of savings and loan institutions were significantly expanded by authorizations to provide checking accounts and to make commercial loans. See S. Rep. 536, 97th Cong., 2d Sess. 15-16 (1982). The expansion of powers has contributed significantly to the large numbers of thrift institutions that subsequently became insolvent or are now facing insolvency. See J. Barth, R. Brumbaugh, D. Sauerhaft & G. Wang, *Insolvency and Risk-Taking in the Thrift Industry: Implications for the Future* 4 (June 20, 1985).

Motor Vehicle Manufacturers Association v. *State Farm Mutual Automobile Insurance Co.*, 463 U.S. 29, 42 (1983). "[An agency] faced with new developments, or in light of reconsideration of the relevant facts and its mandate, may alter its past interpretation and overturn past administrative rulings and practice." *American Trucking Associations, Inc.* v. *Atchison, Topeka & Santa Fe Railway Co.*, 387 U.S. 397, 416 (1967).

Even if it is assumed that the Board's current regulation represents a complete change in position,[57] the Board has clearly provided the "reasoned analysis" required by this Court explaining the rationale for altering earlier, narrow views on whether certain kinds of transactions are commercial loans for purposes of the Act. As the Board stated (Pet. App. 60a), the earlier rulings cited in the court of appeals' decision (*id.* at 5a-6a) were made with respect to institutions basically engaged in very limited banking functions, such as trust companies that did not aggressively solicit deposits and loans (J.A. 93A-103A). Because of the limited operations of these institutions, the Board had no occasion in these rulings to examine the potential for evasion of the purposes of the Act that might arise when banks purposefully seek to exploit the exemption by offering as wide a range of lending services as possible yet without becoming banks for purposes of the Act.[58]

As noted above, as nonbank banks began to proliferate in the early 1980's in reliance on the commercial lend-

[57] As noted, the current definition of commercial loan incorporates the basic test of a commercial lending transaction that the Board established in 1971, soon after the commercial lending test of a bank was added to the Act (J.A. 93A, 97A); 12 C.F.R. 225.2(a)(1)(B).

[58] The court of appeals concluded that transactions once viewed as not involving commercial lending may never be regarded as evasions of the Act (Pet. App. 9a, 10a). This finding ignores the fact (as the Board expressly found here) that after an initial legal interpretation has been issued evidence can develop that certain practices in actual operation produce evasions of the Act.

ing test in the Act,[59] the Board was compelled to reexamine the proper scope of the definition and concluded that the purchase of money market instruments must be viewed as the making of a commercial loan in order to prevent evasion of the Act (J.A. 65A-70A).

C. The Court Below Erred in Failing to Defer to the Board's Expertise in Administering the BHC Act.

The court of appeals failed to give proper weight to the special role Congress has assigned to the Board in administering the BHC Act and adopted an erroneous view of the scope of the express congressional delegation of authority to the Board to issue regulations as may be necessary to carry out and prevent evasions of the Act. 12 U.S.C. 1844(b).

The decision below narrowly construed the Board's statutory authority to prevent evasions, stating that "[t]he authority of the Board under the Act is to be exercised in a restricted area," limited "basically to anticompetitive considerations" (Pet. App. 12a). Such a finding cannot stand, since this Court has expressly rejected assertions that the Act's concern was solely with anticompetitive effects. *Board of Governors* v. *First Lincolnwood Corp.*, 439 U.S. 234 (1978); see *Northeast Bancorp*, slip op. 7-12; *Board of Governors* v. *Investment Company Institute*, 450 U.S. 46, 69-71 (1981); *BT Investment Managers, Inc.*, 447 U.S. at 46-49.

[59] In a March 1981 letter containing no explanation or supporting reasoning, the Board concluded that a bank subsidiary of the Gulf & Western Corp. would not be engaged in making commercial loans for purposes of the Act if it did not purchase certain money market instruments (J.A. 110A-12A). The Gulf & Western letter triggered a wave of acquisitions and proposed acquisitions of nonbank banks by companies engaged in all types of businesses, threatening to create a new class of nonbank banks that were involved in a far greater range of activities than the institutions involved in the earlier rulings (see Pet. App. 24a-25a).

In addition, the decision created its own unusually strict (but undefined) standard of review, ruling that because the Board's action "is a redefinition and expansion of jurisdiction by an agency * * * different standards [must] be met than are demanded in a typical administrative redefinition not involving such elements" (Pet. App. 9a). Such a standard is flatly at odds with the holding of this Court that "the direction in which an agency chooses to move [in changing past policy] does not alter the standard of judicial review established by law." *Motor Vehicles Manufacturers Association*, 463 U.S. at 42.

To the contrary, this Court has made clear that regulations issued pursuant to an express delegation of authority to promulgate regulations necessary to carry out the purposes of a particular statute should be upheld if the regulations are "reasonably related to the purposes of the enabling legislation," *Mourning* v. *Family Publications Service, Inc.*, 411 U.S. 356, 369 (1973), or if they "achieve with reasonable effectiveness the purposes for which [Congress] has acted." *E.I. duPont de Nemours & Co.* v. *Train*, 430 U.S. 112, 132 (1977). Under such a standard, the Board's regulations, which manifestly further the purposes of the Act, should be upheld.

The regulations should also be upheld because the views of the Board, as the expert agency charged with administering the Act, are entitled to substantial weight. This Court has repeatedly recognized that the Board is "an authoritative voice on the meaning of a federal banking statute" (*Northeast Bancorp*, slip op. 7), and that the Board's interpretation of the BHC Act "is entitled to the greatest deference." *Securities Industry Association*, No. 83-614, slip op. 8, quoting *Board of Governors* v. *Investment Company Institute*, 450 U.S. at 56

(1981).[60] See *Board of Governors* v. *Agnew*, 329 U.S. 441, 450 (1947) (Rutledge, J., concurring).

Deference to the Board's expertise is particularly appropriate in the circumstances of this case. Since NOW accounts developed after the demand deposit test of "bank" was added to the Act, Congress did "not directly address the precise question at issue" and, accordingly, the court below should have deferred to the Board's inclusion of such accounts as demand deposits as a "reasonable interpretation made by the administrator" of the statute. *Chevron, U.S.A., Inc.* v. *Natural Resources Defense Council, Inc.*, No. 82-1005 (June 25, 1984), slip op. 5-6. Similarly, since the statutory language and legislative history are silent as to the particular types of obligations that are commercial loans for purposes of the Act, "considerable weight should be accorded" to the Board's application of that term to specific transactions.[61] *Id.* at 6. See *Unemployment Compensation Commission* v. *Aragon*, 329 U.S. 143, 153 (1946).

[60] Although the court's reasons for lack of deference were stated in its discussion of the commercial loan definition, it is evident that the court's views would apply equally in connection with its review of the demand deposit definition. Indeed, the *First Bancorporation* decision, which deals with the status of demand deposits, fails even to consider the court's duty to accord deference to the Board's expertise in administering the BHC Act.

[61] The court of appeals' obligation to accord deference to the Board's views is not excused by the fact that other regulatory agencies, which are not charged with administering the Act, disagreed with the Board. The Board's jurisdiction under the BHC Act is exclusive and paramount. *Board of Governors* v. *First Lincolnwood Corp.*, 439 U.S. at 250. The comments, cited by the court of appeals (Pet. App. 17a), of other regulatory agencies, which have no experience in construing and applying that Act, are not premised on any common industry understanding of what constitutes a commercial loan, but were based on what manifestly is an unduly narrow and incorrect reading of the purposes of the Act and on the faulty supposition that administrators may never alter their views. Similarly, the opinions of Federal Reserve Banks (Pet. App. 17a) are not binding on the Board. Cf. *First Lincolnwood Corp.*, 439 U.S. at 239-41.

CONCLUSION

The judgment of the court of appeals should be reversed.

Respectfully submitted.

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JULY 1985

APPENDIX

FDIC INSURED NONBANK BANKS: COMMERCIAL BANKS & TRUST COMPANIES*

As of April 12, 1985

Bank	Parent Company	Date Acquired or Opened
1. Investors Bank & Trust Co., Boston, Massachusetts	Eaton & Howard, Vance Sanders Inc., Boston, Massachusetts	1969
2. Bradford Trust Co., New York, New York	Fidata Corp. (formerly Bradford National Corp.), New York, New York	1972
3. Bessemer Trust Company, N.A., New York, New York	Bessemer Group, Inc., New York, New York	12/20/74
4. Bradford Trust Co. of Boston, Boston, Massachusetts	Fidata Corp., New York, New York	1975
5. City Trust Services, N.A., Elizabeth, New Jersey	City Federal Savings & Loan Association, Elizabeth, New Jersey	1/4/77
6. Investors Fiduciary Trust Co., Kansas City, Missouri	Kemper Financial, Inc. (subsidiary of Kemper Corp.) (50%); DST, Inc. (subsidiary of Kansas City Southern Ind.) (50%)	1972
7. Associates National Bank, Concord, California	Gulf & Western Corp., New York, New York	8/12/80
8. Fidelity Management Trust Co., Boston, Massachusetts	Fidelity Management & Research Corp., Boston, Massachusetts	3/5/81
9. Valley National Bank, Salinas, California	Household International Corp., Prospect Heights, Illinois	8/7/81
10. Bradford Trust Company of California, Los Angeles, California	Fidata Corp., New York, New York	7/1/81
11. Boston Safe Deposit & Trust Co., Boston, Massachusetts	Shearson/American Express Inc., New York, New York	9/25/81
12. Fidelity National Trust Co., Glendale, California	Fidelity Federal Savings & Loan Association, Glendale, California	9/23/81
13. Colonial National Bank, Wilmington, Delaware	Teachers Service Org., Willow Grove, Pennsylvania	1/21/82
14. Wellington Trust Co. of Boston, N.A., Boston, Massachusetts	Wellington Management Co., Boston, Massachusetts	3/1/82
15. Suburban Bank/Delaware, Dover, Delaware	Suburban Bank, Bethesda, Maryland	9/15/82
16. Citizens National Bank, Fairfield, Connecticut	Gateway Bank, Norwalk, Connecticut	11/7/83
17. Western Family Bank, N.A., Carlsbad, California	McMahan Valley Stores, Carlsbad, California	4/14/83
18. Marsh & McLennan Trust Co., Boston, Massachusetts	Marsh & McLennan Inc., New York, New York	12/29/82

* Data based upon information received from the Office of the Comptroller of the Currency and the Federal Deposit Insurance Corporation and records of the Board of Governors of the Federal Reserve System. See also *American Banker*, April 16, 1985, at 34-35.

Bank	Parent Company	Date Acquired or Opened
19. Dreyfus Consumer Bank, East Orange, New Jersey	Dreyfus Corp., New York, New York	12/27/82
20. Citizens Fidelity (Ohio), N.A., Cincinnati, Ohio	Citizens Fidelity Corporation, Louisville, Kentucky	7/25/83
21. Dreyfus National Bank & Trust Co., New York, New York	Dreyfus Corp., New York, New York	not yet consummated
22. Beneficial National Bank (USA), Wilmington, Delaware	Beneficial Corp., Wilmington, Delaware	5/11/83
23. Fidelity Bank & Trust Co., Salem, New Hampshire	Fidelity Management & Research Corp., Boston, Massachusetts	6/24/83
24. First National Bank of Wilmington, Delaware	Commercial Credit Company (owned by Control Data Corp.), Baltimore, Maryland	5/20/83
25. J.C. Penney National Bank, Harrington, Delaware	J.C. Penney Company, Inc., New York, New York	6/27/83
26. International Central Bank and Trust Corp., Irvine, California	Continental Corp., New York, New York	6/30/83
27. Prudential Bank & Trust Co., Atlanta, Georgia	Prudential Insurance Company of America, Newark, New Jersey	7/5/83
28. Comerica—Midwest, N.A., Toledo, Ohio	Comerica, Inc., Detroit, Michigan	12/15/83
29. U.S. Trust Co., N.A., Palm Beach, Florida	U.S. Trust Corp., New York, New York	5/21/84
30. Trust Management Bank, Boston, Massachusetts	Trust Management Corp. (Rollert & Sullivan Inc.), Boston, Massachusetts	11/28/83
31. Vanguard Fiduciary Trust Co., Valley Forge, Pennsylvania	Vanguard Group of Investment Cos., Valley Forge, Pennsylvania	not yet consummated
32. E.F. Hutton Bank, Wilmington, Delaware	E.F. Hutton Group Inc., New York, New York	3/26/84
33. American Investment Bank, N.A., Salt Lake City, Utah	Leucadia National Corp., New York, New York	4/2/84
34. The Massachusetts Company, Inc., Boston, Massachusetts	The Travelers Corp., Hartford, Connecticut	1969 [1]
35. Templeton Management & Trust Co., N.A., Ft. Lauderdale, Florida	Principals of the Templeton Group of mutual funds, Nassau, Bahamas	not yet consummated
36. Fidelity National Bank & Trust Co., New York, New York	Fidelity Management & Research Corp., Boston, Massachusetts	not yet consummated
37. Advest Bank, Hartford, Connecticut	Advest Group, Inc., Hartford, Connecticut	8/11/83
38. NBD Delaware Bank, Wilmington, Delaware	NBD Bancorporation, Detroit, Michigan	5/8/84

[1] Bank originally chartered as a trust company and acquired by Travelers in 1969, but received FDIC insurance on 11/7/83.

Bank	Parent Company	Date Acquired or Opened
39. Universal Trust Company, San Juan, Puerto Rico	First Boston, Inc., New York, New York	not yet consummated
40. Depositors First National Bank, New York New York	Individuals associated with the Reserve Fund, Inc.	not yet consummated
41. Dimension Bank of California, N.A., San Mateo, California	Dimension Financial Corp., Denver, Colorado	not yet consummated
42. Dimension Bank of Boca Raton, N.A., Boca Raton, Florida	Dimension Financial Corp., Denver, Colorado	not yet consummated
43. Dimension Bank of Massachusetts, N.A., Newton, Massachusetts	Dimension Financial Corp., Denver, Colorado	not yet consummated
44. Dimension Bank of Virginia, N.A., McLean, Virginia	Dimension Financial Corp., Denver, Colorado	not yet consummated
45. Wilmington Trust Company of Florida, N.A., Stuart, Florida	Wilmington Trust Co., Wilmington, Delaware	not yet consummated
46. Bankers Trust Co. of Florida, N.A., Palm Beach, Florida	Bankers Trust N.Y. Corp., New York, New York	12/26/84
47. Bank of Boston Trust Co. of Southeast Florida, N.A., Deerfield Beach, Fla.	Bank of Boston Corp., Boston, Massachusetts	6/6/85
48. Bank of Boston Trust Co. of Southwest Florida, N.A., Sarasota, Florida	Bank of Boston Corp., Boston, Massachusetts	not yet consummated
49. Suburban Bank/Washington, N.A., Washington, D.C.	Suburban Bancorporation, Bethesda, Maryland	not yet consummated
50. First Deposit National Bank, Tilton, New Hampshire (formerly Citizens National Bank)	Capital Holding Corp., Louisville, Kentucky (formerly owned by Parker Pen Co.)	6/14/84
51. Maryland State Bank, Salisbury, Maryland	Wilmington Trust Co., Wilmington, Delaware	12/28/84
52. Southern Bank of Broward County, Pompano Beach, Florida	Continental Telecom Inc., Atlanta, Georgia	not yet consummated
53. Paine Webber Trust Co., Princeton, New Jersey	Paine Webber Group, Inc., New York, New York	9/13/84 [2]
54. Liberty Bank & Trust Co., Gibbsboro, New Jersey	Aetna Life & Casualty Co., Hartford, Connecticut	12/22/84
55. Merrill Lynch Bank & Trust Co., Plainsboro Township, New Jersey	Merrill Lynch & Co., Inc., New York, New York	12/30/83 [3]
56. Custodial Trust Co., Trenton, New Jersey	Bear Stearns & Co., New York, New York	12/21/84 [4]

[2] State charter granted on 9/13/84; FDIC insurance application pending.

[3] State charter granted and transfer of shares effected on 12/30/83. Opened for business without FDIC insurance 9/84; FDIC insurance application approved 12/17/84.

[4] State charter granted 3/20/84; FDIC insurance granted 12/17/84; opened for business on 12/21/84.

	Bank	Parent Company	Date Acquired or Opened
57.	FNS Bank of New York, New York, New York	First National State Bancorporation, Newark, New Jersey	not yet consummated
58.	Avco National Bank, Anaheim, California	Textron, Inc., Providence, Rhode Island	3/1/85 [5]
59.	Greenwood Trust Co., Greenwood, Delaware	Sears, Roebuck & Co., Chicago, Illinois	1/14/85
60.	Commercial Trust Company, Inc., San Juan (Hato Rey), Puerto Rico	Drexel Burnham Lambert Group, Inc., New York, New York (sub. of Group Bruxelles Lambert s.a., Brussels, Belgium)	1/10/85
61.	Lyndon Guaranty Bank of Ohio, Columbus, Ohio	ITT Financial Corporation, Kansas City, Kansas	not yet consummated
62.	Centurion Bank, Wilmington, Delaware	American Express Co., New York, New York	3/85 [6]

[5] On June 30, 1982, the Comptroller issued a notice of intent not to disapprove the acquisition of Avco National Bank by Avco Corporation under the Change in Bank Control Act. The acquisition was consummated on July 16, 1982. On January 9, 1985, the Comptroller issued a notice of intent not to disapprove the acquisition of Avco Corporation by Textron, Inc. The acquisition was consummated on March 1, 1985.

[6] State charter granted 3/85; FDIC insurance application pending.

NOTE: This table does not include over 200 nonbank banks to be owned by bank holding companies for which the Comptroller has granted preliminary charter approval (beginning on 11/1/84), but which have not yet received Federal Reserve Board approval, and 16 nonbank banks which have received preliminary charter approval from the Comptroller, and Federal Reserve Board approval after January 1, 1985, but which may not open as a result of the preliminary injunction granted by the U.S. District Court for the Middle District of Florida in *Independent Bankers Association of America v. Conover*, No. 84-1403—CIV-J-12.

FDIC INSURED NONBANK BANKS: INDUSTRIAL LOAN COMPANIES *

As of April 12, 1985

	Bank	Parent Company	FDIC Insurance Granted	Date Acquired
1.	Bancorp Finance of Hawaii, Inc., Honolulu, Hawaii	Bancorp Hawaii, Inc., Honolulu, Hawaii [1]	9/26/83	4/7/78
2.	Commerce Savings Lincoln, Inc., Lincoln, Nebraska	Commerce Group, Inc., Lincoln, Nebraska [1]	11/9/83	12/1/72
3.	Commerce Savings Columbus, Inc., Columbus, Nebraska	Commerce Group, Inc., Lincoln, Nebraska [1]	11/9/83	10/30/81
4.	Commerce Savings Scottsbluff, Inc., Scottsbluff, Nebraska	Commerce Group, Inc., Lincoln, Nebraska [1]	11/9/83	6/30/74
5.	GECC Financial Corporation, Honolulu, Hawaii	General Electric Company	11/21/83	8/1/79
6.	Standard Finance Company, Limited, Honolulu, Hawaii	S.F.C. Holdings Corp., Honolulu, Hawaii	11/21/83	1/12/83
7.	First of Omaha Savings Co., Omaha, Nebraska	First National of Nebraska, Inc., Omaha, Nebraska [1]	11/21/83	9/23/77
8.	First Savings Company of Lexington, Inc., Lexington, Nebraska	Dawson Corp., Lexington, Nebraska	11/28/83	9/18/78
9.	Resource Industrial Bank, Denver, Colorado	Integrated Resources, Inc., New York, New York	12/19/83	9/23/83
10.	Citicorp Person-to-Person Financial Center of Utah, Salt Lake City, Utah	Citicorp, New York, New York [1]	12/23/83	1/27/75
11.	Mutual Savings Company of Omaha, Omaha, Nebraska	Mutual Savings Company, Limited, Omaha, Nebraska	1/30/84	8/1/79
12.	Hawaii Thrift & Loan, Honolulu, Hawaii	First Hawaiian, Inc., Honolulu, Hawaii [1]	2/21/84	6/1/75
13.	Southglenn Manufacturers Hanover Industrial Bank, Littleton, Colorado	Manufacturers Hanover Corporation, New York, New York [1]	2/21/84	8/29/80
14.	Manufacturers Hanover Industrial Bank, Denver, Colorado	Manufacturers Hanover Corporation, New York, New York [1]	2/21/84	8/29/80
15.	Denver Manufacturers Hanover Industrial Bank, Denver, Colorado	[illegible]facturers Hanover [illegible]ation, New York, [illegible]ork [1]	2/21/84	8/29/80
16.	Broadway Manufacturers Hanover Industrial Bank, Denver, Colorado	Manufacturers Hanover Corporation, New York, New York [1]	2/21/84	8/29/80
17.	Westminster Manufacturers Hanover Industrial Bank, Westminster, Colorado	Manufacturers Hanover Corporation, New York, New York [1]	2/21/84	8/29/80
18.	Intermountain Thrift & Loan Company, Salt Lake City, Utah	Utah Bancorporation, Salt Lake City, Utah	3/26/84	6/30/81

* Data based upon information received from the Federal Deposit Insurance Corporation and records of the Board of Governors of the Federal Reserve System.

[1] The institution is a registered bank holding company.

Bank	Parent Company	FDIC Insurance Granted	Date Acquired
19. Rainbow Finance Corp., Honolulu, Hawaii	Hawaii Resort Industries, Inc., Honolulu, Hawaii	4/23/84	11/20/61
20. State Savings Company of Schuyler, Schuyler, Nebraska	Denver, Inc., Schuyler, Nebraska	5/14/84	5/16/80
21. Servco Financial Corp., Honolulu, Hawaii	Servco Pacific, Inc., Honolulu, Hawaii	5/14/84	10/15/79
22. Finance Factors, Ltd., Honolulu, Hawaii	Finance Enterprise, Ltd., Honolulu, Hawaii	6/4/84	10/3/77
23. Heritage Thrift and Loan Association, Brea, California	Centennial Beneficial Corporation, Orange, California [1]	6/11/84	3/9/82
24. Realty Finance, Inc., Hilo, Hawaii	Realty Investment Co., Ltd., Hilo, Hawaii	6/25/84	4/12/70
25. Paradise Finance, Inc., Honolulu, Hawaii	Aloha Corporation, Honolulu, Hawaii	6/25/84	4/26/72
26. Citicorp Industrial Bank (Now Citicorp Savings and Industrial Bank), Aurora, Colorado	Citicorp, New York, New York [1]	7/23/84	5/26/82
27. Citicorp Person-to-Person Colorado Springs Industrial Bank (Now Citicorp Savings and Industrial Bank of Colorado Springs), Colorado Springs, Colorado	Citicorp, New York, New York [1]	7/23/84	5/26/82
28. Citicorp Person-to-Person Lakewood Industrial Bank (Now Citicorp Savings and Industrial Bank of Southwest Plaza), Lakewood, Colorado	Citicorp, New York, New York [1]	7/23/84	5/26/82
29. Citicorp Person-to-Person Northglenn Industrial Bank (Now Citicorp Savings and Industrial Bank of Northglenn), Northglenn, Colorado	Citicorp, New York, New York [1]	7/23/84	1/15/82
30. Citicorp Person-to-Person Englewood Industrial Bank (Now Citicorp Savings and Industrial Bank of Littleton), Englewood, Colorado	Citicorp, New York, New York [1]	7/23/84	5/26/82
31. Citicorp Person-to-Person Fort Collins Industrial Bank (Now Citicorp Savings and Industrial Bank of Fort Collins), Fort Collins, Colorado	Citicorp, New York, New York [1]	7/23/84	10/27/75
32. Citicorp Person-to-Person Boulder Industrial Bank (Now Citicorp Savings and Industrial Bank of Boulder), Boulder, Colorado	Citicorp, New York, New York [1]	7/23/84	10/26/82
33. Citicorp Person-to-Person Denver Industrial Bank (Now Citicorp Savings and Industrial Bank of Denver), Denver, Colorado	Citicorp, New York, New York [1]	7/23/84	5/26/82

[1] The institution is a registered bank holding company.

Bank	Parent Company	FDIC Insurance Granted	Date Acquired
34. Landmark Thrift & Loan, San Diego, California	Olympian Bancorp, San Diego, California [1]	8/6/84	1/3/83
35. Household Aurora Industrial Bank, Aurora, Colorado	Household Finance Corp., Prospect Heights, Illinois	8/13/84	2/22/80
36. Household Weld County Industrial Bank, Greeley, Colorado	Household Finance Corp., Prospect Heights, Illinois	8/13/84	12/10/76
37. Household Longmont Industrial Bank, Longmont, Colorado	Household Finance Corp., Prospect Heights, Illinois	8/13/84	7/23/80
38. Citicorp Person-to-Person Financial Center, Inc., Omaha, Nebraska	Citicorp, New York, New York [1]	8/27/84	9/1/82
39. Investors Thrift, Orange, California	Tomar Financial, Orange, California	9/24/84	11/12/82
40. Fireside Thrift Company, Redwood City, California	Teledyne, Inc., Los Angeles, California	10/1/84	9/68
41. Citizen Thrift and Loan Association, Irvine, California	Western Interstate Bancorp, Irvine, California	10/29/84	11/21/86
42. Sierra Thrift, Fresno, California	WKS, Inc., Fresno, California	10/29/84	2/1/84
43. Metropolitan Thrift & Loan, Oakland, California	MTB Corp., Oakland, California	12/17/84	9/1/83
44. Nevada First Thrift, Reno, Nevada	Nevada First Development Company, Reno, Nevada [1]	12/17/84	7/31/84
54. Parker Industrial Bank, Parker, Colorado	Douglas Bancorporation, Inc., Parker, Colorado [1]	3/11/85	9/30/83

[1] The institution is a registered bank holding company.

(6)

No. 84-1274

IN THE
Supreme Court of the United States
OCTOBER TERM, 1985

BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM,
Petitioner
v.
DIMENSION FINANCIAL CORPORATION, *et al.*,
Respondents

On Writ of Certiorari to the United States Court of Appeals for the Tenth Circuit

BRIEF FOR RESPONDENTS DIMENSION FINANCIAL CORPORATION, *ET AL.*

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THE QUESTIONS PRESENTED

The Bank Holding Company Act of 1956, as amended, uses the term "bank" to circumscribe the scope of the Federal Reserve Board's jurisdiction under that Act. A covered "bank" is defined in the Act to include a financial institution only if it both "(1) accepts deposits that the depositor has a legal right to withdraw on demand, and (2) engages in the business of making commercial loans." 12 U.S.C. § 1841(c) (1982).

The questions presented by this case are whether the court of appeals correctly concluded that the Federal Reserve Board exceeded its authority under the Act when the Board amended its implementing Regulation Y to expand the definition of a BHCA "bank" and thus the Board's jurisdiction by:

(a) redefining the statutory "legal right to withdraw on demand" requirement to include "any deposit with transactional capability that, as a matter of practice, is payable on demand;" and

(b) redefining the statutory "commercial loan" requirement to include the "purchase of retail installment loans or commercial paper, certificates of deposit, bankers' acceptances and similar money market instruments, the extension of broker call loans, the sale of federal funds, and the deposit of interest-bearing funds."

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BRIEF FOR RESPONDENTS DIMENSION FINANCIAL CORPORATION, *ET AL.*

STATEMENT

This case concerns the Congressional allocation of jurisdiction among various federal and state agencies to regulate financial institutions and, in particular, the scope of jurisdiction granted the Board of Governors of the Federal Reserve System ("Board") under the Bank Holding Company Act of 1956, as amended, 12 U.S.C. § 1841 *et seq.* (1982) ("BHCA" or "Act"). The Board's regulation implementing the Act is Regulation Y, 12 C.F.R. Part 225 (1985). This case arises from challenges by respondent Dimension Financial Corporation ("Di-

mension")[1] and other aggrieved parties to the Board's 1983 revision of Regulation Y to fundamentally alter its jurisdiction under the Act.[2]

The Bank Holding Company Act represents one—but only one—segment of the carefully wrought framework developed by Congress for the regulation of financial institutions. Different types of institutions are subject to varying regulatory schemes and requirements, which are administered by agencies at both the federal and state level. The Office of the Comptroller of the Currency ("Comptroller") charters and comprehensively regulates national banks under the National Bank Act and related statutes. 12 U.S.C. §§ 21-216 (1982). The Federal Deposit Insurance Corporation ("FDIC") is responsible for insuring and overseeing the financial soundness of national banks, savings banks, and other qualified institutions. 12 U.S.C. §§ 1811-1832 (1982). Congress gave another agency, the Federal Home Loan Bank Board, responsibility to charter and regulate federal savings and loan associations, which are then insured by the Federal

[1] Dimension is a holding corporation that has sought approval from the Office of the Comptroller of the Currency to establish and operate 31 new national banks in 25 states. *See* Statement of Corporate Affiliations, Joint Brief of Respondents in Opposition to Petition for Certiorari (March 7, 1985). Pursuant to Supreme Court Rule 28.1, Dimension states that its affiliate, Valley Federal Savings & Loan Association of Hutchinson, Kansas, has become affiliated with Interstate Federal Corporation.

[2] The Board's brief on the merits is cited here as "Pet. Br.," the Joint Appendix as "J.A.," and the Appendix to the Board's petition for certiorari as "Pet. App." The Documentary Supplement filed with respondents' joint brief in opposition to the petition is cited as "Rspt. Doc. Supp." The Board proposed its amendment to Regulation Y at 48 Fed. Reg. 23520 (May 25, 1983), published the final amendment at 49 Fed. Reg. 794 (Jan. 5, 1984), and published its Supplementary Information Appendix A to justify the amendment it had made at 49 Fed. Reg. 833-842 (Jan. 5, 1984).

Savings & Loan Insurance Corporation ("FSLIC").[3] Other federal agencies regulate specific activities of financial institutions, such as securities and options trading, and certain investment advice and investment banking activities. Finally, Congress has preserved the authority of states to charter and regulate such institutions as industrial banks, and state banks and savings and loans.[4]

As part of this framework, the Bank Holding Company Act grants the Board regulatory jurisdiction over companies that own "banks." Not all banks, however, are considered "banks" under the BHCA (hence the term "non-BHCA banks" or "nonbank banks"). For purposes of this jurisdictional grant, Congress defined "bank" as an institution that *both* receives "deposits that a depositor has a legal right to withdraw on demand" *and* "engages in the business of making commercial loans." BHCA § 2(c), 12 U.S.C. § 1841(c).

In December 1983, the Board adopted an amendment to Regulation Y that dramatically expanded the scope of its jurisdiction by redefining both components of the statutory BHCA "bank" definition. 49 Fed. Reg. 794 (Jan. 5, 1984). In particular, the Board redefined the "commercial loan" component to sweep in institutions that engage in passive investment activities such as money market and interbank transactions, including:

[3] 12 U.S.C. § 1437 *et seq.* (1982); 12 U.S.C. § 1421 *et seq.* (1982); 12 U.S.C. § 1461 *et seq.* (1982); 12 U.S.C. § 1724 *et seq.* (1982).

[4] "Financial firms or transactions are subject to an exceedingly complex jurisdictional web in which authority is shared among seven primary federal regulatory agencies, hundreds of state and local agencies, and many special purpose organizations." *Blueprint For Reform: The Report of the Task Group on Regulation of Financial Services*, 8 (1984), *reprinted in* Fed. Banking L. Rep. (CCH) No. 1050 (Nov. 16, 1984). *See generally* W. Schlichting, *et al.*, 1 *Banking Law* §§ 2.03, 3.02 (1985); 14 W. Fletcher, *Cyclopedia of the Law of Private Corporations* §§ 6802, 6804 (perm. ed. 1980).

> [T]he purchase of retail installment loans or commercial paper, certificates of deposit, bankers' acceptances, and similar money market instruments, the extension of broker call loans, the sale of federal funds, and the deposit of interest-bearing funds.

12 C.F.R. § 225.2(a)(1)(1985). Before the amendment, Regulation Y had directly incorporated the statutory definition of a "bank," 12 C.F.R. § 225.1 (1983), and these activities had never been considered "commercial lending." Similarly, to extend BHCA jurisdiction to institutions that offer "NOW" accounts and other transactional accounts, the Board redefined the "legal right to withdraw on demand" component of the statutory "bank" definition to mean "any deposit . . . that, as a matter of practice, is payable on demand." 12 C.F.R. § 225.2(a)(1)(1985).

The consequences of the Board's proposed expansion of its jurisdiction would be dramatic both for coordinate regulatory bodies and for the affected institutions. For example, the Board's assertion of authority would overlap or intrude upon the Comptroller's authority to regulate the activities of national banks under the National Bank Act, and would force state-chartered institutions to terminate their existing deposit insurance in favor of FDIC insurance. *See* Rspt. Doc. Supp., Add. I; Pet. App. 44a. In addition, companies that owned banks or other financial institutions that would now be newly denominated as BHCA "banks" could no longer own or engage in most other types of nonbanking businesses, and they would also become subject to additional limitations on the acquisition of other banks. 12 U.S.C. §§ 1842, 1843(a), 1843(c)(8). As the court below concluded in describing the "pervasive changes" the Board's redefinition would cause:

> [T]his expansion of jurisdiction was very much more than just the prevention of future acquisitions, arrangements or affiliations. It was to cause divestitures of old acquisitions, sale of assets, changes in permitted uses of excess funds by state chartered and other institutions. It also was to have a drastic impact on many other types of business arrangements and on the way business was conducted, who could insure deposits and changes in regulatory authority from states to the "feds."

744 F.2d 1402 at 1405, 1406.

Accordingly, Dimension and a number of other organizations and institutions that had relied on the prior "bank" definition filed timely petitions for review of the Board's amendment to Regulation Y pursuant to 12 U.S.C. § 1848. Dimension is a holding corporation that has received preliminary approval from the Comptroller of the Currency initially to establish and operate any four national banks of a proposed eventual network of thirty-one such banks. Dimension's banks will focus on the *consumer* financial services market and will not engage in the business of making "commercial loans" as that term is commonly used and was previously defined. *See* pages 40-42 and note 45 *infra*. Because the Board's new definition of commercial loans would severely restrict the kinds of investment activities in which Dimension can engage, Dimension's petition focused on the "commercial loan" aspect of the Board's redefinition.[5]

Dimension's petition and the petitions for review filed in other circuits were ordered consolidated before the

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[5] Dimension's brief here likewise primarily addresses the validity of the Board's redefinition of the "commercial loan" provision. Respondents American Financial Services Association, *et al.*, are filing a separate brief concerning the impropriety of the Board's redefinition of the "legal right to withdraw on demand" provision. Although these two issues are related, and together emphasize the extent of the Board's departure from Congress' intent in enacting and amending the BHCA, they are independent grounds for invalidating the Board's amended Regulation Y.

Court of Appeals for the Tenth Circuit pursuant to 28 U.S.C. § 2112(a). On September 24, 1984, that court invalidated the Board's redefinition of both the "commercial loan" component and the "legal right to withdraw on demand" component challenged by other parties. 744 F.2d at 1402.

The Solicitor General, after obtaining two extensions to consider the issue, authorized the Board to file a petition for writ of certiorari on its own behalf, which subsequently was filed on February 6, 1985. The petition was granted on April 29, 1985.

SUMMARY OF THE ARGUMENT

Congress has allocated jurisdiction to regulate financial institutions among a number of administrative agencies. In exercising this legislative responsibility, Congress has enacted and amended the statutes prescribing jurisdiction as it finds appropriate to accommodate beneficial changes, meet newly perceived needs, and transfer regulatory authority. Contrary to the suggestion of the Board's brief here, the authority and jurisdiction of the Federal Reserve Board within this framework are not plenary. Rather, the Board shares its regulatory role with other coordinate federal agencies, including the Comptroller and the FDIC, and with the states, and only Congress can expand or contract the Board's jurisdiction.

Congress granted the Board jurisdiction under the Bank Holding Company Act, in particular, to regulate institutions that manage or control "banks," as that term is specifically defined in the BHCA. Congress did *not* confer upon the Board the power to redefine its own jurisdiction. Nevertheless, the Board's amendment to Regulation Y fundamentally redefines a "bank" under the BHCA and would unilaterally expand the Board's jurisdiction at the expense of other regulators. The rationale for this redefinition, moreover, is not that the meaning of the statutory language Congress chose has

changed. Instead, the Board's acknowledged justification is its belief that certain developments in the financial market should be deterred and that the Board should be allowed now to reach institutions that otherwise would be regulated under statutes other than the BHCA. *See* Pet. Br. at 4-6.

1. The Board's action is impermissible because it violates the clear language, purpose, and history of the BHCA by sweeping into the Act a large number of institutions that Congress never considered "banks." Congress enacted the BHCA in 1956 to prevent excessive concentration of credit and to separate commercial banking and commerce. To those ends, Congress initially granted the Board jurisdiction over institutions that owned or controlled national or state banks, savings banks or trust companies. From the outset, however, Congress intended to limit the BHCA's scope to only those institutions needed to accomplish the Act's purposes.

In succeeding years, Congress twice narrowed the definition of "bank" to include only those institutions that both "accep[t] deposits that the depositor has a legal right to withdraw on demand" and that "engag[e] in the business of making commercial loans." 12 U.S.C. § 1841 (c). In adopting the "commercial loan" component of this definition in 1970, Congress purposefully excluded institutions that transacted in other, more passive investments that did not involve the potential for abuse in commercial credit to which the BHCA was directed. *See* pages 11-22 *infra*.

The clearest example of the impropriety of the Board's redefinition of the "commercial loan" limitation is that it sweeps back into the statute Boston Safe Deposit and Trust Company, an institution that Congress specifically intended to exclude in 1970 because it made no commercial loans. At that time, Boston Safe engaged in the very money market and interbank transactions that the Board's new regulation now labels "commercial lending."

Contrary to the Board's arguments, moreover, the 1970 amendments were not a private bill meant to exclude Boston Safe alone; the legislative history demonstrates that Congress intended to exclude *any* institution that did not engage in commercial lending. The Board's proposal now to "grandfather" some institutions like Boston Safe merely underscores the fact that the new Regulation Y would cover institutions Congress meant to exclude. *See* pages 19-21, 32-33 *infra.*

Beginning shortly after Congress enacted the "commercial loan" limitation in 1970, the Board consistently interpreted that term as excluding the same passive investment activities the Board would now include. In this series of decisions and opinion letters issued over twelve years, the Board specifically concluded that purchases of commercial paper, certificates of deposit and bankers' acceptances, the extension of broker call loans, the sale of federal funds to other banks, and comparable money market and interbank transactions do *not* constitute "commercial loans." This contemporaneous and longstanding interpretation demonstrates persuasively that the Board's new redefinition is inconsistent with the statutory language and Congress' intent, and that the redefinition is not entitled to the special deference the Board claims. *See* pages 22-27 *infra.*

When the Board abruptly changed its position in late 1982, in comments on the acquisition of a state bank by the Dreyfus Corporation, and subsequently adopted the amended Regulation Y, other federal financial regulators confirmed that the Board's new definition of "commercial loans" does not accord with Congress' understanding of the term or with the purposes of the BHCA. The Comptroller, the FDIC, three Federal Reserve Banks, and several members of Congress all commented that the Board's definition represented an impermissible attempt to expand its own jurisdiction. *See* pages 27-31 *infra.*

2. The Board is not entitled now to override Congress' "commercial loan" limitation simply because it believes

that market developments since 1970 would support enlarging the Board's jurisdiction. The Board's reversal of position has not been premised on any change in the nature or use of money market and interbank transactions that suddenly rendered them "commercial loans." The Board therefore cannot justify its reversal in terms of the characteristics of such instruments. These instruments are typically traded in a manner (*e.g.*, on a secondary market) which does not involve the type of lender-borrower relationship that can create a potential for abuses in the control and allocation of commercial credit, such as credit tying and discriminatory favoritism. Indeed, there is nothing even "commercial" about interbank transactions, and redefining "commercial loans" to include transactions between banks would be inconsistent with Congress' intent to distinguish in the BHCA between commercial banking and commerce.

More fundamentally, the Board's *post hoc* assertions that Congress' original objectives would be better served now by enlarging the Board's jurisdiction cannot justify this agency's effort to overrule Congress' intent as actually expressed in the Act. The Board's so-called "evasion" power also does not permit the Board unilaterally to expand its own jurisdiction. That evasion power necessarily corresponds to the scope of the Board's jurisdiction under the Act, and gives no authority to enlarge the Board's jurisdiction. Where Congress has determined that certain institutions' activities place them outside the Act's jurisdiction—and decided not to regulate those activities under the BHCA—the conduct of those lawful activities is no "evasion" of the Act or its purposes. *See* pages 31-45 *infra.*

3. The Board's new definition represents an effort to impose *its* policy view of what jurisdiction it should have without Congressional authorization and at the expense of coordinate federal agencies with different policy views. This arrogation of legislative power exceeds the constitutional role of an administrative agency and is particu-

larly inappropriate where, as here, Congress has declined to enact temporary legislation sought by the Board to accomplish these same changes and where Congress is continuing to weigh the appropriate scope of BHCA jurisdiction in proposals for permanent legislation. *See* pages 45-50 *infra*.

ARGUMENT

I. THE BOARD'S NEW DEFINITION OF "COMMERCIAL LOANS" IS IMPROPER, BECAUSE IT IS INCONSISTENT WITH THE LANGUAGE, PURPOSE, AND HISTORY OF THE BHCA.

Congress, and only that legislative body, bears the responsibility for assigning regulatory jurisdiction to administrative agencies and allocating jurisdiction among agencies. The principle has long been established that an agency cannot exceed the scope of the authority delegated by Congress, whether by regulation or administrative interpretation.[6] Just as an agency cannot exceed its granted jurisdiction, an agency also cannot use the "power to issue regulations" to "extend a statute or modify its provisions." *Campbell* v. *Galeno Chemical Co.*, 281 U.S. 599, 610 (1930). Even where an agency has consistently held that it possesses jurisdiction denied by Congress—which is not the case here, as shown *infra*—"an agency may not bootstrap itself into an area in which it has no jurisdiction." *Federal Maritime Commission* v. *Seatrain Lines, Inc.*, 411 U.S. 726, 745 (1973).

The definition of the term "commercial loans" in the BHCA determines the Board's jurisdiction under that Act. The validity of the Board's new definition of "commercial loans" in amended Regulation Y is therefore an

[6] *See, e.g., Peters* v. *Hobby*, 349 U.S. 331, 345 (1955); *Stark* v. *Wickard*, 321 U.S. 288, 309-10 (1944); *International Railway Co.* v. *Davidson*, 257 U.S. 506, 514-15 (1922); *United States* v. *Wickersham*, 201 U.S. 390, 398 (1906); *Marbury* v. *Madison*, 5 U.S. (1 Cranch) 137, 165-66 (1803).

issue of law, which governs the proper extent of the Board's jurisdiction. Such an issue is, of course, a matter for resolution by the courts on the basis of Congress' chosen statutory language and legislative intent. *FEC* v. *Democratic Senatorial Campaign Committee*, 454 U.S. 27, 31-32 (1981); *SEC* v. *Sloan*, 436 U.S. 103, 116-19 (1978); *Federal Maritime Commission* v. *Seatrain Lines, Inc.*, 411 U.S. at 745-46; *FTC* v. *Colgate-Palmolive Co.*, 380 U.S. 374, 385 (1965); *see* 5 U.S.C. § 706 (1982). As this Court emphasized in *International Brotherhood of Teamsters* v. *Daniel*, 439 U.S. 551 (1979), the interpretation of an agency's authority is "constrained by our obligation to honor the clear meaning of a statute, as revealed by its language, purpose, and history." *Id.* at 566 n.20. *Accord Securities Industry Association* v. *Board of Governors*, 104 S. Ct. 2979, 2983 (1984) (court must reject Board construction of statute that is inconsistent with the statutory mandate).

In this case, the Board's attempt unilaterally to expand its jurisdiction by promulgating an amended regulation that redefines the statutory term "commercial loans" is improper, because the Board's new definition conflicts with the clear language, purpose, and legislative history of the Bank Holding Company Act.

A. The Board's New Definition Contradicts the Language, Purpose, and Legislative History of the BHCA by Including Institutions that Congress Purposefully Excluded.

Congress has progressively narrowed the definition of a "bank" for purposes of the Bank Holding Company Act since the statute was originally enacted in 1956. As one step in this pattern of narrowing the reach of the Act, Congress added the "commercial loan" limitation to the "bank" definition in 1970. Like earlier legislative determinations, the purpose of this amendment was to exclude a category of institutions from the Act's jurisdic-

tion because Congress determined that the purposes of the Act did not require reaching those institutions. The Board's new definition of "commercial loans," which serves virtually to eliminate this limitation, is inconsistent both with Congress' intent for the limitation and with the overall direction of Congress' decisions to confine the definition of a covered "bank."

The original 1956 Act incorporated a charter-based test for the definition of a "bank." Institutions that were chartered as national or state banks, savings banks, or trust companies were considered "banks" subject to the BHCA. BHCA § 2(a) & (c) (1956). In choosing this broad definition, however, Congress made clear that it did not intend the BHCA to cover all financial institutions, but rather only those institutions believed necessary at that time to fulfill the Act's objectives. *See* S. Rep. No. 1095, 84th Cong., 1st Sess. 7-8, *reprinted in* 1956 U.S. Code Cong. & Ad. News 2482, 2489.

Congress thus tailored the original definition of a "bank" to enable the Act to achieve two main goals. First, Congress believed that "adequate safeguards should be provided against undue concentration of control of banking activities." *See* S. Rep. No. 1095 at 1. Second, and stemming from this first goal, Congress sought to keep certain types of banking activities separate from commercial activities, and therefore intended for bank holding companies to "confine their activities to the management and control of banks" and to avoid those activities "having no close relationship to banking." *Id.* Nevertheless, Congress determined from the outset that the scope of the Act—and the definition of a covered "bank" —should be as narrow as possible to accomplish the Act's goals:

> [T]he definitions in this bill will adequately cover the organizations which should be included in the scope of [the BHCA] without unnecessarily encompassing organizations that need not be included in order to accomplish the purposes of [the BHCA].

S. Rep. No. 1095 at 8.[7]

Congress determined in 1966 after reviewing the scope and operation of the BHCA that the charter-based definition of a covered "bank" was overly broad. Accordingly, Congress eliminated this original definition and substituted a narrower, more specific test. In particular, the 1966 amendments redefined "bank" as an institution that "accepts deposits that the depositor has a legal right to withdraw on demand."[8] The express purpose of this new definition, as the Board has recognized, was to exclude a number of financial institutions from the Act's coverage, based on Congress' determination that the statutory goals could be achieved without applying the Act to savings banks, trust companies, and industrial banks.[9] Indeed, the Board itself approved this narrowing

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[7] The Board's brief here virtually ignores Congress' first goal, and seeks to uphold the Regulation Y redefinitions largely on the basis of the Board's view of Congress' second purpose. This omission is not coincidental, since it is widely acknowledged that the development of non-BHCA banks actually increases competition in the banking and financial services industry (*see* pages 47-48 *infra*), and Congress' desire to promote competition and prevent undue concentration therefore conflicts with the Board's current effort to hinder the formation of non-BHCA banks. *See* Rspt. Doc. Supp., Add. I & J. Ironically, the legislative history demonstrates that Congress became concerned with the separation of certain banking activities from commercial activities only in connection with threats of undue concentration and insufficient competition. *See generally* Brief of Sears, Roebuck & Co., *et al.* as *Amici Curiae* in support of respondents.

[8] Pub. L. No. 89-485, § 3, 80 Stat. 236 (1966). The legislative history of these 1966 amendments is discussed in greater detail in the separate brief of respondents American Financial Services Association, *et al.*

[9] S. Rep. No. 1179, 89th Cong., 2d Sess. 7, *reprinted in* 1966 U.S. Code Cong. & Ad. News 2385, 2391. *See* Pet. App. at 24a; S. Rep. No. 1084, 91st Cong., 2d Sess. 24, *reprinted in* 1970 U.S. Code Cong. & Ad. News 5519, 5541.

of jurisdiction at the time, stating that "we see no reason in policy to cover such institutions under this act. . . ." [10]

The "commercial loan" limitation was added in 1970, when Congress determined that even the "legal right to withdraw" definition was too inclusive. In Congress' view, institutions that were not engaged in the business of making commercial loans also could safely be excluded from the "bank" definition without undermining the statutory goals. A commercial loan traditionally consists of a direct loan from a bank to a business customer, upon terms negotiated between the bank and that customer, for the purpose of providing funds needed by the customer in its business to meet working capital needs and finance inventory. *See* Pet. Br. at 39 (citing *United States* v. *Connecticut National Bank*, 418 U.S. 656, 665 (1974)). Such a loan, and the negotiation of its terms, necessarily involves a close lender-borrower relationship which can blur the separation of a commercial lender's activities from those of the business to which it lends, and creates the opportunity and potential for the lending bank to influence the borrower's financial operations or engage in improper credit tying or discriminatory conduct in the extension of credit.[11]

[10] Letter to the Hon. A. Willis Robertson, Chairman, Senate Committee on Banking and Currency, from J.L. Robertson, Vice Chairman, Board of Governors (April 20, 1966), *reprinted in Amend the Bank Holding Company Act of 1956: Hearings on S.2353, S.2418, and H.R. 7371 Before Subcomm. of the Senate Comm. on Banking & Currency*, 89th Cong., 2d Sess. 447 (1966).

[11] In a letter submitted to the Senate Committee, the Board itself expressed this very rationale for distinguishing between "commercial loans" and other kinds of transactions engaged in by institutions exempted by the 1970 amendments. Letter from Federal Reserve Board Vice Chairman J. L. Robertson to the Hon. John Sparkman, Chairman, Senate Committee on Banking and Currency (June 1, 1970), *reprinted in One-Bank Holding Company Legislation of 1970: Hearings Before the Senate Comm. on Banking and Cur-*

[Footnote continued]

Congress recognized that the purposes of the Act—"to restrain undue concentration of commercial banking resources and to prevent possible abuses related to the control of commercial credit"—required coverage only of banks that made commercial loans and presented a potential for these abuses, yet permitted the exclusion of banks that did not make such loans. S. Rep. No. 1084 at 24. According to the Committee Report accompanying the Senate bill, Congress previously had thought that the 1966 amendment would "exclude those institutions not engaged in commercial banking." *Id.* Upon learning otherwise in 1970, Congress considered the 1966 definition to be "too broad" and sought again to avoid subjecting to the BHCA "institutions which are not in fact engaged in the business of commercial banking in that they do not make commercial loans." *Id.*

To accomplish this narrowing of jurisdiction, Congress amended the definition of "bank" to exclude specifically those institutions that do not "engage in the business of making commercial loans." [12] Although not the proponent of this amendment, the Board did concur at the time, noting that "there is less need for concern about preferential treatment in extending credit where no commercial loans are involved." [13]

rency, 91st Cong., 2d Sess. 136-37 (1970). The Board also continued to rely on this rationale in decisions and interpretations for twelve years after enactment of the 1970 amendments. *See* pages 22-27 *infra*.

[12] Pub. L. No. 91-607, § 101(c), 84 Stat. 1760, 1762 (1970). Contrary to the Board's argument here, Congress' decision to narrow the definition of a "bank" was entirely consistent with its simultaneous decision to extend the Act to companies that controlled only one such bank. Pet. Br. at 42. While Congress subjected institutions properly considered "banks" to strengthened regulation, it also found that other institutions should not be considered BHCA "banks" in the first instance and, therefore, should not be regulated at all under the BHCA.

[13] Letter from Federal Reserve Board Vice Chairman J. L. Robertson to the Hon. John Sparkman, Chairman, Senate Committee on Banking and Currency (June 1, 1970), *supra* note 11, at 136-37.

The Board's attempt now to redefine these BHCA terms in Regulation Y to acquire jurisdiction over so-called "nonbank banks" is fundamentally inconsistent with Congress' decisions to narrow those same terms. Thus, rather than deal with the historical pattern of Congressional intent, the Board's brief seizes upon the fact that when Congress defined a BHCA "bank" as an entity that engages in the business of making commercial loans, Congress did not take the further step of enacting a specific definition of a "commercial loan." The Board suggests that this "failure" leaves it free to define that term. Pet. Br. at 39. If accepted, this argument's exclusive focus on the form of Congressional action, to the exclusion of recognizing Congress' substantive intent and purpose, would demand an unprecedented and unrealistic level of specificity by Congress. The rule cannot be that Congress cedes unlimited discretion to an agency to ignore legislative intent whenever Congress elects not to define all the subsidiary terms in a statutory definition.

Even in the absence of a specific statutory definition, the Board's redefinition of the "commercial loan" limitation cannot be reconciled with the language Congress did use and the intent it otherwise expressed. According to the Board, the commercial loan requirement is satisfied by any "direct or indirect extension of credit to a business organization" and the establishment of some "debtor-creditor relationship." Pet. Br. at 38-39. The statute, however, explicitly refers to "*making* commercial loans," and by these terms an institution that does not *make* the loan to the borrower cannot be a "bank." 12 U.S.C. § 1841(c) (to be a "bank," an institution must "engag[e] in the business of making commercial loans"). The "making" term thus limits the definition to institutions having some direct relationship with the borrower in extending the commercial loan. The term logically and necessarily excludes the purchase of commercial paper and other money market instruments in the secondary market that the Board now seeks to reach as "indirect" extensions of credit.

Congress' selection of the words "commercial loans" likewise precludes the Board's redefinition. This wording, on its face, should limit the definition to transactions ordinarily considered as "loans." Transactions described as "purchases of commercial paper" and "purchases of certificates of deposit" literally are purchases, like the purchase of a municipal bond or a security, and not "loans." Similarly, Congress' wording should also limit the definition to loans to "commercial" entities, not banks or consumers. In fact, given the Board's assertion that Congress intended for the BHCA to "separate banking from commerce," Congress could not simultaneously have intended to equate banks with commercial enterprises and thereby separate "banking from banking." Yet this is precisely what the Board's redefinition requires, by including in "commercial loans" such *interbank* transactions as the sale of federal funds, the purchase of certificates of deposit, and the deposit of interest-bearing funds.[14] These inconsistencies between the Board's redefinition and the actual words of the BHCA demonstrate an irreconcilable conflict between the Board's action and Congress' intent. For " 'no more persuasive evidence' " of Congress' intent can exist than the very " 'words by which the legislature undertook to give expression to its wishes.' " *Griffin* v. *Oceanic Contractors, Inc.*, 458 U.S. 564, 571 (1982).

Congress enacted the "commercial loan" limitation based on the common banking usage of those words at the time, which was considerably narrower than what the Board has now proposed in order to expand its jurisdiction. As this Court recognized in a nearly contempo-

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[14] The inclusion of interest-bearing deposits in the new commercial loan definition further highlights the difficulty of squaring that definition with the actual language of the statute. Coupled with the Board's new view of the "demand deposit" component of the Act's definition of "bank," this inclusion would mean that a BHCA bank would now be, in essence, any institution that "accepts and makes deposits." If this result had really been intended, Congress could have reached it by a much more direct route.

raneous decision, *United States* v. *Connecticut National Bank*, 418 U.S. 656 (1974), now curiously cited by the Board (Pet. Br. 39), "commercial loans" were considered different from "loans for securities purchases, trust services, investment services, computer and account services, and letters of credit." *Id.* at 665. Furthermore, a Board publication in the record of that case, which the Court relied upon, listed "commercial and industrial loans" as a category of bank assets separate and apart from "Federal funds sold," "customers' liabilities on acceptances outstanding," "loans to brokers and dealers in securities" and "other securities." [15]

The Board's redefinition simply ignores these traditional distinctions.[16] Had Congress meant for the BHCA to include institutions generally involved in supplying any form of "direct or indirect credit" to any type of "business entity," it would not have enacted the con-

[15] *See* 418 U.S. at 665 (citing App. 1793, which was Exhibit GX 118, a joint publication of the FDIC, the Board, and the Comptroller entitled "Assets and Liabilities—Commercial and Mutual Savings Banks—December 31, 1971).

[16] The only transaction the Board attempts to justify as a commercial loan based on any sort of traditional analysis or understanding is the purchase of commercial paper. Pet. Br. at 39-40. However, the materials the Board cites fall far short of equating these terms. Moreover, contrary to the Board's reliance on *Securities Industry Ass'n* v. *Board of Governors*, 104 S. Ct. 2979 (1984), that decision actually *rejected* the Board's argument that "commercial paper more closely resembles a commercial loan." *Id.* at 2987. Rather, the Court held that commercial paper constituted a "security" for purposes of the Glass-Steagall Act. In addition, the Court's statement that "the authority to discount commercial paper . . . places banks in their traditional role," *id.* at 2991, does not support the Board's position in the present BHCA context. Banks engage in many "traditional" investment activities, such as trading in government securities, which even the Board concedes are not "commercial loans" under the BHCA. *See* note 35 *infra*. Congress limited the BHCA to "commercial loans," and in particular, only those banks that actually engage in "making" the commercial loans. *See* page 16 *supra*.

siderably narrower "commercial loan" language. That language, when coupled with the "demand deposit" component of the BHCA "bank" definition, necessarily serves to distinguish "commercial banking" from *other categories* of banking and financial services. Indeed, this Court based its decision in *Connecticut National Bank* on the separate attributes and status of "commercial banks," notwithstanding the fact that other types of banks do compete directly with "commercial banks" in many respects. 418 U.S. at 660-66.

The Board suggests alternatively, and inconsistently, that no matter what Congress actually legislated, it really only meant to enact a private bill to exempt from the BHCA one institution, the Boston Safe Deposit & Trust Company. Pet. Br. at 13, 41. Yet the 1970 amendments were enacted as a public law and codified as such, not as a private bill.[17] Moreover, although the Boston Safe situation may have prompted the enactment of the "commercial loan" limitation, the Senate Committee Report is unequivocal in explaining that the amendment was

[17] The Board bases its suggestion on the fact that Senator Brooke of Massachusetts introduced the commercial lending provision. In fact, however, Senator Brooke had introduced a comprehensive bill to amend the BHCA, and this provision was originally a part of that bill. *See* S. 3823, 91st Cong., 2d Sess. (1970); 116 Cong. Rec. 14818-22 (1970). *See generally* Brief of Sears, Roebuck & Co., *et al.* as *Amici Curiae*.

The Board also takes out of context a quote from the House conferees to make it appear as though they had a specific intent that the commercial loan provision be interpreted narrowly. *See* Pet. Br. at 41-42. In fact, the conferees were referring in general terms to all nine of the 1970 amendments' exemptions. More importantly, interpreting an exemption "narrowly" still requires giving the exemption the full construction and effect Congress intended. In any event, the passage the Board quotes is of doubtful value, since the commercial loan provision was added by the Senate, and Senator Sparkman specifically cautioned at the time that "language in a statement of [House] managers cannot be authoritative on the question of a Senate amendment" to this legislation. 116 Cong. Rec. 42422 (1970).

intended to exclude *any* "institutions that are not engaged in the business of making commercial loans." S. Rep. No. 1084 at 24.[18]

The circumstances concerning Boston Safe nevertheless are illustrative of the inconsistency between the Board's redefinition and the legislative history. Boston Safe at the time received demand deposits but did "no commercial lending." 116 Cong. Rec. 25848 (1970). It did, however, engage in precisely the kind of money market and interbank transactions that the Board would now define as commercial loans.[19] Consequently, even if one assumed *arguendo* that Congress intended to exclude only Boston Safe and institutions engaged in identical activities, that intent would preclude sustaining the Board's new definition of commercial loans.

To avoid this inconsistency with the legislative history, at the same time the Board suggests that the 1970 amendments constituted a private bill for Boston Safe, the Board also contends that Congress enacted the private

[18] The Senate Committee Report's description of this exemption in broad and generic terms, using the plural "institutions," can be contrasted with the Report's reference to another provision as being prompted by a "unique situation existing in the State of Missouri" involving only a "limited number of trust companies." *Compare* S. Rep. No. 1084 at 24 *with id.* at 12. Congress knew very well how to describe a unique or limited exemption, and it chose not to use such a description for the "commercial loan" exemption.

The Comptroller's Office has similarly concluded, based on its expertise and understanding of the legislative history, that "it is clear that the narrowing of the definition of 'bank' was not intended to be applicable only to Boston Safe." J.A. at 77A.

[19] The Regulation Y comment letter of Boston Safe's parent company confirmed that "[i]n 1970, Boston Safe purchased money market instruments (e.g., certificates of deposit, commercial paper and bankers' acceptances) and sold Federal funds—activities included in the proposed [Board] definition." Rspt. Doc. Supp., Add. T at 2. The letter pointed out that the Board's new commercial loan definition would now "render Boston Safe a 'bank' for purposes of the BHC Act and Regulation Y." *Id.*, Add. T at 1.

bill without knowing that Boston Safe engaged in these money market and interbank activities. Pet. Br. at 43. In effect, the Board argues that Congress' action in 1970 should be nullified because Congress did not know what it was doing. Such an assumption of Congressional ignorance cannot be supported as a matter of fact or law, nor can the Board's startling approach to statutory analysis based on that assumption be reconciled with the judiciary's appropriate role in interpreting federal legislation.[20] Simply put, the Boston Safe situation clearly demonstrates the inconsistency between the Board's new definition of "commercial loans" and Congress' intent, by sweeping back into the Act institutions Congress purposefully excluded.

In summary, the Board's new regulation, which in effect renders Congress' 1970 commercial loan limitation a nullity, is inconsistent with both the statutory language and the legislative history. The principle is well settled that Congress will not be presumed to enact a provision that is without meaning or is unnecessary,

[20] C. Sands, *Sutherland Statutory Construction* § 45.12 (4th rev. ed. 1984) (legislative language must be interpreted by courts on the assumption that the legislature was aware of relevant statutes and facts). The Board's argument is based on the fact that the legislative history does not expressly note Boston Safe's money market and interbank activities. Pet. Br. 43. Yet the Board points out that Congress had become familiar with Boston Safe's situation during the 1966 amendments, Pet. Br. at 43 n.53, and it strains credulity to suggest that Congress legislated twice in the dark. A far more plausible explanation is that there simply was no need or occasion to refer to Boston Safe's specific activities. Congress was concerned with "commercial loans," and no one had ever considered this term to include money market and interbank transactions. Congress had no reason to reiterate an obvious proposition, which was confirmed shortly thereafter by the Board's *express* determination that Boston Safe's money market and interbank transactions did not constitute "commercial loans" as that term had been used by Congress. *See* pages 22-23 *infra*. Significantly, the Board's brief carefully stops short of affirmatively claiming that *it* was unaware of Boston Safe's specific activities in 1970.

and an interpretation such as the Board's that emasculates the words Congress chose must be rejected. *See United States* v. *Menasche*, 348 U.S. 528, 539 (1955); C. Sands, *Sutherland Statutory Construction* §§ 45.12, 46.06 (4th rev. ed. 1984) (it cannot be presumed that Congress would do a futile thing).

B. The Board's Own Contemporaneous and Longstanding Definition of "Commercial Loans" from 1970-1982 Excluded the Very Instruments the Board Now Attempts to Include.

From 1970 to late 1982, when the Board perceived a need to expand its jurisdiction, the Board consistently held that the term "commercial loans" does not include passive investment activities such as money market and interbank transactions. According to the Board's decisions, companies that engage in such activities are not subject thereby to the BHCA. This "contemporaneous interpretation of a . . . statute by an agency charged with its enforcement" is entitled to far greater weight in ascertaining Congress' original intent than the Board's new redefinition, which largely ignores that intent. *See BankAmerica Corp.* v. *United States*, 462 U.S. 122, 130-32 (1983); *Skidmore* v. *Swift & Co.*, 323 U.S. 134, 140 (1944). Moreover, the longstanding "want of assertion of power" over institutions which engage in money market and interbank transactions by those charged with the enforcement of the BHCA demonstrates that the Board itself did not believe the "power was actually conferred." *BankAmerica Corp.* v. *United States*, 462 U.S. at 131 (quoting *FTC* v. *Bunte Brothers, Inc.*, 312 U.S. 349, 352 (1941)). *Accord FPC* v. *Panhandle Eastern Pipe Line Co.*, 337 U.S. 498, 513 (1949).

The Board first announced its contemporaneous construction in 1972 when Boston Safe sought an official confirmation that its investment activities did not constitute "commercial loans." The Board concluded that Boston Safe's purchases of certificates of deposit, commercial paper, and bankers' acceptances were "not regarded as commercial loans for purposes of the Act," and that the sale of federal funds was not "tantamount to the making of a commercial loan" for purposes of the BHCA.[21] Thus, the Board's initial regulatory expression on the definition of "commercial loan" coincided with the limitations intended by Congress' 1970 amendments.

The Board's understanding of Congress' intent was repeated and explained more fully in a 1976 opinion from its Legal Division concerning broker call loans. In this opinion, the legal staff explained the characteristics of money market instruments that distinguish them from commercial loans. Investment vehicles like call loans, the Board's staff emphasized, are entered on a daily basis with a mutual option not to renew, are a temporary means of investing idle funds and are viewed by the investing institution as an alternative to other money market instruments, such as commercial paper or certificates of deposit.[22] Significantly, the opinion letter recognized that call loans are a "passive medium of investment," in which the lender bases his investment decision on its analysis of money market rates (*id.*)—not the attractiveness of the borrower, as is the case with commercial lending. As a result, call loans lack the close lender-borrower relationship that poses the potential for credit abuses at which the BHCA was principally directed:

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[21] Letter to Lee J. Aubrey, Vice President, Federal Reserve Bank of Boston, from Michael A. Greenspan, Assistant Secretary, Board of Governors, at 2 (May 18, 1972) (J.A. 94A). Although the Board added the qualifier "in the circumstances of this case," neither in this letter itself nor in any subsequent statement has the Board identified the "circumstances" referred to, or how the meaning of the statutory term can vary in other circumstances.

[22] Letter to Michael A. Greenspan, Metzger, Noble, Schwartz & Kemplar, from Baldwin B. Tuttle, Deputy General Counsel, at 2-3 (January 26, 1976) (J.A. 100A-101A).

'Call loans' thus do not appear to have the close lender-borrower relationship that is one of the characteristics of commercial loans and which presents the possibility of abuses relating to the control of commercial credit that concerned the Congress in adopting the commercial lending test.

Id. Accordingly, the 1976 opinion concluded that broker call loans were not "commercial loans" within the meaning of the BHCA. *Id.*

In 1980, the Board's Legal Division again distinguished "commercial loans" from other "passive medi[a] of investment" when it held that the purchase of the guaranteed portions of SBA and FHA loans through nonbank dealers on the secondary market did not constitute commercial lending. Again, the opinion concluded that these instruments "do not appear to involve the particular type of lender-borrower relationship that is one of the characteristics of commercial loans, and which presents the possibility of abuses relating to the control of commercial credit that concerned Congress when it adopted the commercial lending test, found in the Act." [23]

An internal Board memorandum prepared in February 1981 summarized the Board's longstanding interpretation and concluded that money market instruments, such as certificates of deposit, commercial paper and bankers' acceptances, and the purchase of federal funds, did not constitute commercial loans, nor were broker call loans or securities transactions "commercial loans" for purposes of the BHCA. Federal Reserve System, Office Correspondence (February 10, 1981) (J.A. at 96A-98A). In summarizing the consistent understanding followed by the Board from the first decisions after Congress enacted the commercial loan limitation in 1970, the memorandum concluded:

[23] Letter to William McDonough, Assistant General Counsel, Federal Reserve Bank of Boston, from Robert E. Mannion, Deputy General Counsel, at 2 (November 13, 1980) (J.A. 104A-105A).

In each instance, the Board or its staff found that these transactions did not involve the particular type of lender-borrower relationship that is one of the characteristics of commercial loans, and which presents the possibility of abuses relating to control of commercial credit that concerned Congress when it adopted the commercial lending test.

Id. (J.A. at 97A-98A).

The Board reaffirmed this position later in 1981 when it approved the legal basis for the acquisition of Fidelity National Bank by Associates First Capital Corporation, a subsidiary of Gulf & Western, a non-banking corporation. The national bank had divested its entire commercial lending portfolio, but continued to engage in various money market and interbank transactions.[24] Despite this continuing money market activity, the Board concluded that Fidelity was not engaged in commercial lending and thus was not a "bank" as that term is used in the BHCA.[25]

Similarly, the Board in 1982 approved or took no action with regard to several acquisitions in which the acquired institution both offered NOW accounts and engaged in money market and interbank transactions.[26] In

[24] *See* Bank Admin. Instit., Innerline, Index of Bank Performance (1982) (Associates National Bank) (J.A. 108A). Fidelity was later renamed Associates National Bank.

[25] Letter to Robert C. Zimmer, Zimmer & Einhorn, from James McAfee, Assistant Secretary, Board of Governors (March 12, 1981) (J.A. 110A-112A).

[26] *See, e.g.*, Rubenstein, "Household Finance Parent to Enter Banking By Acquisition," *American Banker* at 1 (July 13, 1981) (J.A. 113A-115A); "Fed Allows Citicorp to Acquire Fidelity," *American Banker* (Sept. 30, 1982) (J.A. 116A-126A); [1981-1982 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 98,770 (May 28, 1981) (Chrysler Corp.). The Board required Chrysler to forego the use of commercial paper and bankers' acceptances, but did not indicate that other money market and interbank instruments were barred.

the case of Citibank, which was permitted to acquire a savings and loan, the Board determined that "a federally insured savings and loan association that offers NOW accounts and exercises no greater commercial lending powers than are now permitted to a federal savings and loan association . . . is not a 'bank' for purposes of the BHC Act." J.A. at 128A. Since a savings and loan's "lending powers" include the unlimited power to purchase several types of money market and interbank instruments, the Board necessarily determined that such activities did not entail "commercial lending." *See* 12 U.S.C. § 1464(c) (1976) (amended 1982).[27]

The Board's brief barely mentions the existence of these prior decisions and its contemporaneous construction of the commercial loan limitation. When it does, the Board only briefly suggests that these decisions were "isolated cases" or that they "were made in the context of institutions engaged in very limited functions." Pet. Br. at 4, 17, 47. To the contrary, the reasoning of these decisions confirms that they rested on a thorough inquiry into the nature of the transactions involved. The decisions were not based on the size of the institutions or the volume of their business, and the Board has not offered a principled explanation for expanding and contracting the statutory "commercial loan" term when applied to different financial institutions. In fact, these decisions reveal a clear, consistent pattern of contemporaneous construction, uncontradicted by any other decisions during these twelve years. The nature, source and reasoning of the decisions reveal that they are far from being "isolated cases."

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[27] Indeed, even in the Board's *Beehive* decision in March 1981, when the Board first announced its new definition of the "demand deposit" requirement, the Board continued to recognize that such passive instruments as certificates of deposit, government securities, and interbank trading vehicles were not considered "commercial loans." 68(4) Fed. Res. Bull. 253, 254 n.5 (Apr. 1982).

The Board's brief thus appears to proceed primarily on the assumption that even if its new regulation does reflect a "complete change in position," the Board is free to do so. Pet. Br. at 46-47. However, the question here is one of ascertaining Congress' intent when it enacted the "commercial loan" limitation in 1970, and that Congressional intent controls the current meaning of the limitation and the resulting scope of BHCA jurisdiction. *See* pages 10-11 *supra*. While the Board may reverse its own views on some questions, the Board cannot reverse Congress' intent, particularly not Congressional intent regarding the Board's jurisdiction. *See* pages 32-38 *infra*. Thus, the real significance of the Board's history of contemporaneous statutory construction is not just that the Board has "changed its mind," but rather that its own long-held interpretations of the BHCA persuasively demonstrate a Congressional intent for the Act that precludes the new definition the Board now advances in order to expand its jurisdiction.

C. The Response of Other Federal Financial Regulators Confirms the Inconsistency of the Board's New Definition with Congress' Intent.

The response of other federal regulatory agencies further demonstrates how far the Board's new definition of commercial loans departs from common usage and the purposes of the BHCA. The Board first signalled its reversal of position on the "commercial loan" limitation in December 1982, in connection with a proposal by Dreyfus Corporation to acquire the Lincoln State Bank. Despite Dreyfus' plans to follow the same format approved in the Gulf & Western case (*see* page 25 *supra*), the Board asserted in a letter to the FDIC that this acquisition would be subject to the BHCA.[28] For the first

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[28] Letter to William M. Isaac, Chairman, FDIC, from William W. Wiles, Secretary, Board of Governors (December 10, 1982) ("Dreyfus Letter") (J.A. 65A-70A). Lincoln, a state-chartered bank, was

[Footnote continued]

time, the Board announced that the previously limited "commercial loan" term now included the purchase of "commercial paper, bankers acceptances, and certificates of deposit, the extension of broker call loans, the sale of federal funds, the deposit of interest bearing funds and similar lending vehicles." *Id.* at 68A.

The FDIC, in response to the Board's Dreyfus letter, reminded the Board that "a number of clear precedents exist, dating back a number of years, for a bank to be held exempt from the definition of 'bank' in the Bank Holding Company Act based on the divestiture of its commercial loan portfolio prior to the acquisition and its agreement not to engage in the business of making commercial loans in the future."[29] "[C]onstrained to follow the clear legal precedents established over the years," the FDIC approved the Dreyfus acquisition, noting that the Board had "dramatically re-cast the definition of commercial loan by including within it certain activities that clearly had been excluded from the definition in the past." *Id.* at 91A-92A.

The Comptroller of the Currency also opposed the Board's sharp reversal. In approving Dreyfus' separate request for a national bank charter, the Comptroller's Office concluded "that the inclusion of money market transactions within the BHCA term 'commercial loans' is not supported by the purpose or the legislative history of the BHCA."[30] Following the same view the Board had previously adhered to, the Comptroller recognized

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insured by the Federal Deposit Insurance Corporation and FDIC permission for the acquisition was needed irrespective of the BHCA.

[29] Letter to William W. Wiles, Secretary, Board of Governors, from Margaret L. Egginton, Deputy to the Chairman, FDIC at 1 (December 29, 1982) (J.A. 90A).

[30] Comptroller Decision To Charter Dreyfus National Bank & Trust Company (February 4, 1983) (J.A. 71A, 76A).

that Congress in 1970 had exempted institutions not engaged in commercial lending like Boston Safe, which was then dealing in the very instruments that the Board now labelled "commercial loans."[31]

When the Board nevertheless subsequently proposed to amend Regulation Y, to force the expansion of its jurisdiction, the FDIC and the Comptroller's Office again submitted opposing comments, repeating the criticisms raised in their Dreyfus Letters. Rspt. Doc. Supp., Add. D & Add. C. Both the FDIC and the Comptroller's Office emphasized that the jurisdictional definition of "bank" was a matter properly determined only by Congress. *Id.*, Add. C at 5. As the FDIC recognized, "[t]he Board is attempting to resolve by regulation serious issues that will affect the entire financial industry" and "a wiser alternative is to encourage Congress" to analyze what, if any, legislative response was necessary. J.A. at 33A.

In addition to the expert views of these two coordinate agencies, three Federal Reserve Banks submitted comments emphasizing that the new Regulation Y pushed the Board's jurisdiction under the BHCA beyond the bounds set by Congress. The Atlanta Federal Reserve Bank warned that the Board's reinterpretation improperly expanded the scope of the BHCA's jurisdiction, noting that "[s]ince the new definition of commercial loans has no basis in tradition or in the BHC Act it appears to pro-

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[31] *Id.* at 77A-78A. The Comptroller's statement reaffirmed, as the Board had previously concluded, that money market and interbank instruments were "essentially passive medi[a] of investment, are reviewed on a very frequent basis, and do not involve a close lender-borrower relationship." *Id.* at 79A. Accordingly, they posed "little potential of involving the types of commercial lending abuses" to which the BHCA was directed. *Id.* The Comptroller also recognized that the Board's new position violated the limited scope of the BHCA, noting that "Congress did not intend" the limiting 1970 amendments to be so interpreted "as to subject to the BHCA those financial institutions which need not be subject" to the Act to accomplish its purposes. *Id.* at 77A.

vide an overly broad extension of the regulation." Rspt. Doc. Supp., Add. E. at 3. The Federal Reserve Bank of San Francisco recognized the same overextension, noting that "we are not convinced that the Board's expansive reading of 'bank' is justified, or [that] Congress intended that so-called 'nonbank banks' be subject to Board authority under the Bank Holding Company Act." J.A. at 30A. The Federal Reserve Bank of Chicago similarly labelled the commercial loan redefinition "unduly restrictive." Rspt. Doc. Supp., Add. G at 1.[32]

Even members of Congress submitted comments that the Board's proposal far exceeded the reach intended by the 1970 amendments. Recognizing that "Congress has been wrestling with the problems of banking deregulation and the expansion of financial services for some time," Senator Abdnor questioned the propriety of the Board's action. Rspt. Doc. Supp., Add. L at 1. Similar concerns were voiced by legislators on both sides of the Capitol. *See id.*, Add. M (Representative Parris), Add. N (Representative Shumway), Add. O (Senator Simpson), Add. P (Senator Trible), Add. Q (Representative Vento), and Add. R (Representative Dreier).

In light of these comments by coordinate expert agencies and legislators, and the Board's own contrary contemporaneous construction, the Board's claim here of entitlement to "greatest deference" for its "expertise" is difficult to credit. Pet. Br. at 49-50. *See, e.g., FCC* v. *American Broadcasting Co.*, 347 U.S. 284, 294-98 (1954) (in areas of shared expertise and responsibility, courts must consider the expert views of coordinate agencies). No provision in the BHCA authorizes the Board to adjust the "commercial loan" limitation to expand the Board's jurisdiction by administrative fiat, and this case does not involve a review of Board discretion in acting pursuant to such a non-existent statutory delegation.

[32] In a classic rendition of "pay no attention to that man behind the curtain," the Board fleetingly observes at the end of its last footnote that "the opinions of Federal Reserve Banks . . . are not binding on the Board." Pet. Br. at 50 n.61. But what is technically "binding" is, of course, beside the point. The Federal Reserve Banks are at least as well versed in the common usage of the term "commercial loan," and in the nature and uses of various financial instruments, as the Board. Indeed, they have even more "hands-on" experience in dealing with these instruments and in the day-to-day regulation of bank holding companies. Accordingly, the Board's plea for deference in this case is seriously undermined when its constituent banks—the major source of the particular "expertise" the Board now invokes—disagree with the Board's interpretation and state that it is exceeding the jurisdictional limits of the BHCA.

Rather, the issue here is what Congress intended the "commercial loan" limitation to exclude when Congress redefined the jurisdictional limits of the Act in 1970. The expert views of the FDIC, the Comptroller's Office, and the Federal Reserve Banks are consistent with the Board's own contemporaneous construction, and persuasively confirm that the Board's original interpretation accurately reflected Congress' intent. *See BankAmerica Corp.* v. *United States*, 462 U.S. 122, 132 (1983). The Board's new view on this issue of legal interpretation, based on the Board's unilateral determination to expand its jurisdiction rather than a reassessment of Congress' original intent—and given its inconsistency with the contemporaneous construction—is entitled to little or no deference at all. *See General Electric Co.* v. *Gilbert*, 429 U.S. 125, 141-43 (1976); *Skidmore* v. *Swift & Co.*, 323 U.S. 134, 140 (1944).

II. CONGRESS DID NOT GIVE THE BOARD AUTHORITY TO OVERRIDE THE "COMMERCIAL LOAN" LIMITATION AND EXPAND THE SCOPE OF THE BOARD'S JURISDICTION.

The Board advances essentially two rationales for sustaining its redefinition of the "commercial loan" limitation and enlarging the Board's jurisdiction. First, the Board contends that due to developments since 1970, Congress' original purposes would support expanding the Board's jurisdiction to reach institutions previously ex-

empted from the Act. Second, the Board asserts that its authority to prevent "evasions" of the Act supports overriding the "commercial loan" limitation as originally conceived. Neither rationale can withstand analysis.

A. The Board's *Post Hoc* Arguments About the Nature of Money Market and Interbank Transactions in View of Marketplace Developments Can Not Justify the New "Commercial Loan" Definition.

The Board's brief seeks to sustain the Board's redefinition on the ground that Congress' objectives for the Act would now be better served by enlarging the Board's jurisdiction. This contention is misconceived even at its premise, since the Board's policy arguments cannot permit the *Board* to override administratively Congress' enactment of the "commercial loan" limitation in 1970. Moreover, the Board has advanced these arguments only as *post hoc* rationalizations for its action and has never been able to relate these arguments to Congress' actual purpose for enacting the BHCA.

The demarcation of jurisdiction under the BHCA is an issue of law to be resolved based on Congress' intent. *See* pages 10-11 *supra*. Contrary to the Board's suggestion in its claim to great deference, this is not an instance where Congress failed to express any intent. Pet. Br. at 50. As demonstrated above, Congress' intent in 1970 can be discerned, and the Board's redefinition is inconsistent with that intent. *See* pages 14-21 *supra*.

Indeed, the Board's record itself provides one of the clearest illustrations of that inconsistency and of the true nature of the Board's action. In recognition that sweeping Boston Safe back under the Act would openly violate Congress' intent, the Board has offered to "grandfather" Boston Safe.[33] However, this solution cannot excuse the

[33] *See* Board Legal Division Memorandum, Record at 1445-46. The Board did not even hazard an explanation of how it could override the terms of the BHCA by exempting institutions which it now claims are subject to the Act, and which, under the Board's new interpretation, have been operating illegally for over twelve years.

conflict with Congress' intent to exclude that institution based on the same money market and interbank transactions at issue now. "The law does not permit an agency to exercise powers expressly denied it by Congress if it includes a variance mechanism that perhaps will be used to bring the agency's regulations within the boundaries established by the statute." *In re Surface Mining Regulation Litigation*, 627 F.2d 1346, 1358-59 (D.C. Cir. 1980). While the Board may offer a regulatory loophole of its own to permit institutions like Boston Safe to "petition the Board for relief on grounds of unfairness or hardship," this offer cannot obscure the invalidity of a definition that requires institutions like Boston Safe to "petition" the Board in the first place. The Board's quasi-legislative grandfathering thus actually emphasizes the fact that the Board's redefinition turns the legislative history on its head and would render Congress' specific intent to exclude such institutions a nullity.

The Board's current arguments about the purported "true" nature of money market and interbank transactions, in view of recent developments in the industry, therefore constitute nothing more than its assertion that Congress' 1970 action was or has become "deficient" in some manner. *See* Pet. Br. at 39-41, 47-48. But these assertions and new policy arguments cannot reverse Congress' intent. Rather, those assertions are for Congress to weigh against competing policies—as it is now doing—and not for the Board to implement unilaterally. *See* pages 45-50 *infra*.

Not only are the Board's policy justifications misdirected, but they also have all been offered as *post hoc* rationalizations, *see Securities Industry Association* v. *Board of Governors*, 104 S. Ct. at 2983-84, and are unrelated to Congress' actual purposes in enacting and amending the BHCA. In particular, when the Board first proposed its amendment of Regulation Y, the only rationale given was the desire to simplify the regulation and

revise filing and processing procedures for applications under the Act. Merely passing reference was made to its inclusion of the new "bank" definition (48 Fed. Reg. at 23521), and the Board tendered no elaboration or rationale for its revisions to that definition in either the Background and Summary section of the rulemaking notice or the accompanying Regulatory Analysis. Only subsequently, in an Appendix published at the time it finally adopted the revised Regulation Y, did the Board identify the "factual" and policy grounds it thought relevant and attempt to justify the redefinition.[34]

The grounds eventually invoked by the Board for its reformulation, moreover, ignore the fact that at the time of the 1970 commercial loan amendment, Congress was primarily concerned with preventing possible abuses related to the control and allocation of commercial credit, such as unfair tying and discriminatory treatment. *See* pages 14-15 *supra;* Pet. Br. 42. Congress believed that this policy goal of the BHCA was adequately served by limiting the Act's coverage to banks that engage in commercial lending. The straightforward principle applied by Congress was that an institution which does not make loans to commercial entities in the first place cannot abuse the allocation of such credit.

The money market and interbank transactions that the Board now labels "commercial loans" are not susceptible to the abuses Congress intended to prevent because they

[34] *See* 49 Fed. Reg. 794, at 833-42. As a result, the Board prevented Dimension and other parties from submitting factual evidence to challenge the "findings" recited in this Appendix and now reiterated in the Board's brief as justifications for the redefinition. Based on the Board's failure to provide adequate notice and allow comment on the purported justifications for the redefinition, Dimension argued in the court of appeals that the Board's amendment violated the notice-and-comment requirements of the Administrative Procedure Act. Ct. App. Jt. Br. at 38-42. The court below did not reach this procedural argument, due to its invalidation of the amendment on substantive grounds.

do not involve the close lender-borrower relationship which affords a realistic potential for tying and discrimination. The Board itself reached exactly this conclusion during the twelve years it consistently acknowledged that "commercial loans" did not include such transactions. *See* pages 22-27 *supra.* The Board has not advanced any plausible rationale now to explain its implicit new conclusion that these investment vehicles, which the Board in the past consistently termed passive investment media, suddenly possess the close lender-borrower relationship and resulting potential for abuse that implicate the BHCA's purposes.

In fact, money market instruments and interbank transactions are employed as short-term vehicles to place temporarily idle funds and are utilized by banks and other financial institutions for asset-liability management. Money market instruments are usually bought and sold through the active secondary market, and their rates are set by general market conditions. As a result, these types of financial instruments are basically fungible.[35] An institution's decision to buy or sell any particular instrument is necessarily made on the basis of typical *investment* considerations like market levels and trends, and prevailing interest rates, and any given transaction can have no appreciable impact upon the entire market or any specific "pair" of buyers and sellers who participate in it.

[35] *See, e.g.*, 63(6) Fed. Res. Bull. 525 (June 1977) (for investors, "commercial paper—because of its relatively low risk and short maturity—is a close substitute for money market instruments such as Treasury bills and large-denomination certificates of deposit (CD's). As a consequence, yields on commercial paper move in concert with yields on these other short-term market instruments.") In addition, the fact that these instruments are interchangeable with government money market instruments further belies any assertion that they are used for purposes other than short-term investment. Even the Board does not claim that government money market instruments are commercial loans. *See* Pet. App. at 46a & n.29.

For example, a purchase of one bank's certificate of deposit does not "favor" that bank since, in an open market of buyers and sellers with competitive rates, the rate at which the certificate of deposit sells is set by the sum total of all buying and selling decisions, not the action of any particular purchaser.[36] Any distortion in the marketplace caused by a large purchase of a particular instrument by a particular buyer would be quickly eliminated through arbitrage, making such an effort pointless. Thus, no single bank could materially affect the market rate at which any money market instruments trade. Moreover, because the rate is set by the market and the terms are usually standardized, the buyer can have no particular influence over the seller.[37]

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[36] Thus, the Board's statement that an institution "could refuse to purchase such instruments from competitors" is mistaken in its implication that such a refusal would have an effect on the seller's ability to sell in the open market. Pet. App. 56a.

[37] The Board claims that a substantial number of money market transactions are the result of direct "negotiations." Pet. Br. at 44. A more correct statement of the Board's support for its assertion is that money market instruments can be the result of direct "sales" (*see* Pet. Br. n.55), which is *not* the equivalent of the Board's suggestion that the instruments are the product of extensive back-and-forth negotiations. Because money market instruments are used as short-term investment vehicles to place temporarily idle funds, the instruments must be liquid. As a result, the instruments contain standardized terms, and even in a direct sale, they trade at rates which merely reflect the secondary market where the instruments must be resold. The nature of these instruments and the market therefore prevent abuses in direct sales.

Furthermore, the Board's commercial loan definition is not even limited to directly negotiated transactions, but also encompasses trading on the secondary market, where there cannot even be a pretense that a buyer can favor or influence a seller, let alone the original issuer of a money market instrument. The original issuer is not even a participant in the secondary market and, instead, has received the proceeds from the instrument's issuance before any trading in that market ever takes place.

For the foregoing reasons, the Board has been unable to point to any real abuses in the marketplace that might justify its new commercial loan definition. Instead, the Board's Appendix published with the redefinition sought to justify the amendment by asserting a "potential" for danger, and the Board's brief repeats this approach. Pet. Br. 44-45. However, these conclusory assertions lack any genuine support in the record. For example, with respect to money market instruments, the Board's Appendix claimed that "even when purchased through brokers, the lender knows the borrower's identity." Pet. App. at 55a. Yet nowhere does the Board explain what significance this fact has. The Board further commented that "[b]ased on its experience, the Board is aware that holders of large amounts of so-called money market instruments relative to the size of the borrower are in a position to influence the conduct of the borrower, and do at times exercise this influence." *Id.* This statement begs all the critical questions, such as who those holders are, how they go about exercising the alleged influence, how long the Board has been "aware" of such activities, and why the Board excluded money market instruments from its interpretation of "commercial loans" for twelve years if it really was aware of such activities. By failing to provide any concrete information to substantiate such assertions, the Board simply demonstrates the absence of any genuine factual support.

In sum, the Board cannot justify its new definition on the ground that, based on its "findings," the Board is entitled to "change its mind" about commercial loans under the standards set forth in *Motor Vehicle Manufacturers Association* v. *State Farm Mutual Automobile Insurance Co.*, 463 U.S. 29 (1983). Pet. Br. 46-47. Certainly the Board has not provided the type of "reasoned analysis," responsive to the basis for its contemporaneous interpretation and Congress' purposes, that this decision requires. But more fundamentally, the issue in this case is one of jurisdiction and statutory construction, not the

exercise of acknowledged regulatory power. In this context, even if the Board could provide a "reasoned analysis" for the change, it would not authorize the Board to expand its own jurisdiction in a manner that conflicted with Congress' intent, as evidenced by the language and legislative history of the statute.[38] *See* pages 10-11 *supra* and 49-50 *infra*.

No matter how strenuously the Board lays claim to special deference (Pet. Br. 48-50), the Board cannot redefine its own jurisdiction or rewrite Congress' purposes. Here, moreover, even simple deference is limited, since the Board is attempting to expand its jurisdiction by an abrupt change in policy that does

> not demonstrate the sort of longstanding, clearly articulated interpretation of the statute which would be entitled to great judicial deference, particularly in light of the clear indications that Congress did not intend to vest the [agency] with the authority it is now seeking to assert.

Federal Maritime Commission v. *Seatrain Lines, Inc.*, 411 U.S. 726, 745 (1973).

B. The Board's Claimed Power to Prevent Evasions Does Not Expand the Scope of Authority Conferred by Congress.

In apparent recognition that the "commercial loan" provision cannot be reinterpreted to include money market and interbank transactions instruments based on assertions of their use or abuse, the Board also seeks to justify its position by relying on its purported authority to prevent "evasion" of the BHCA where banks seek to offer "as wide a range of lending services as possible yet without becoming banks for purposes of the Act." Pet. Br. 47. This rationale is equally incapable of expanding the Board's jurisdiction. Where, as here, Congress has explicitly excluded certain activities from the scope of the Act, no evasion occurs when an institution engages in those activities but is not otherwise subject to the Act. The Board's "evasion" argument merely confirms the position of the other federal financial regulators—that the Board is attempting to expand the reach of the Act and its own jurisdiction through unilateral administrative action when the decision is one properly for Congress.

[38] The Board's reliance on other decisions for this argument is also misplaced. *Chevron U.S.A., Inc.* v. *NRDC, Inc.*, 104 S. Ct. 2778 (1984), dealt with a situation where Congress had no intent on the question resolved by the agency, and the Court unambiguously held that where Congress *had* expressed an intent, the agency must give effect to that intent and the "judiciary is the final authority on [such] issues of statutory construction." *Id.* at 2781-82 & n.9. *American Trucking Ass'ns, Inc.* v. *Atchison, Topeka & Santa Fe Ry. Co.*, 387 U.S. 397 (1967), dealt with the ICC's authority to "overturn past administrative rulings and practice," not Congressional limitations. *Id.* at 416.

This Court has previously recognized in a number of cases involving the Securities and Exchange Commission's remedial powers under § 10(b) of the 1934 Securities Exchange Act, that an agency's "evasion" authority does not permit it to rewrite statutory limits. Thus, in *Chiarella* v. *United States*, 445 U.S. 222 (1980) (Powell, J.), the Court held that an employee of a financial printer did not violate the securities laws by using for personal gain information obtained in documents delivered to the printer prior to their public distribution. As the Court explained, that securities law attacks only "frauds" and where, as in that case, no fraud was shown, the agency could go no further. The Court reasoned that the 1934 Act "cannot be read more broadly than its language and the statutory scheme reasonably permit" and while "Section 10(b) is aptly described as a catchall provision, . . . what it catches must be fraud." *Id.* at 234-35 (quoting *Touche Ross & Co.* v. *Redington*, 442 U.S. 560, 578 (1979)).

Similarly, the Court in *SEC* v. *Sloan*, 436 U.S. 103, 116 (1978) (Rehnquist, J.), in ways precisely applicable to the Board's reliance on its evasion authority here, recognized the limits to the SEC's power under § 12(k)

of the Securities Exchange Act of 1934 to suspend trading in any security for up to ten days. The Court questioned the use of § 12(k) for purposes beyond "those clearly contemplated" by the statute as a "solution to virtually any other problem which might occur in the marketplace." *Id.* at 117. Continuing, the Court said this summary suspension power "was not meant to be such a cure-all" and while "[i]t provides the Commission with a powerful weapon for dealing with certain problems," its limits are "clearly and precisely defined" and "cannot be judicially or administratively extended simply by doubtful arguments as to the need" for regulation. *Id.* at 117. "If extension of the summary suspension power is desirable," the Court concluded, "the proper source of that power is Congress." *Id.*

The same limitations apply here. The Board's evasion authority is necessarily defined and limited by the scope of the Act itself. An institution which chooses to engage in activities other than those Congress has determined to implicate the purposes of the Act does not thereby "evade" the Act and thus subject itself to Board jurisdiction. A manufacturer does not "evade" the Act by financing the purchase of its products but not otherwise engaging in financial activities that would bring it within the Act's purview.[39]

The overbreadth and illogic of the Board's evasion rationale can be seen with respect to Dimension's proposal to establish and operate 31 national banks in 25 states. These institutions will be "consumer banks," di-

[39] The Board at several points implies that the BHCA gives it plenary authority to regulate the financial activities of major nonbanking corporations. *See, e.g.*, Pet. Br. 20-21. In fact, major corporations have always engaged in extensive financial activities outside the scope of the BHCA. A study recently published by the Federal Reserve Bank of Chicago showed that "[i]n 1972, at least ten nonfinancial firms had significant financial services earnings, and by 1981 this list had grown over three-fold." Pavel & Rosenblum, "Banks and Nonbanks: The Horse Race Continues," *Economic Perspective*, 4 (May/June 1985).

rected at serving the financial needs of individuals, and will not engage in the business of commercial lending. In granting preliminary approval to this proposal after extensive hearings and written submissions, the Comptroller found "that the convenience and needs of the communities involved will be best served by approval of the Dimension applications." [40] Contrary to the Board's suggestion that "nonbank banks" are not subject to necessary safeguards to ensure their safety and soundness (Pet. Br. 12, 23), the Dimension system will consist of national banks fully regulated by both the Comptroller and the FDIC.[41] Indeed, as future members of the federal reserve system, the Dimension national banks will even be subject to important Board regulations concerning reserve requirements and interest rates. 12 C.F.R. Parts 204, 217 (1985).

In these circumstances, the Dimension system is no "evasion" of the BHCA's provisions or purposes.[42] Rather, by not engaging in the business of commercial lending, the Dimension banks will simply not be the type of financial institutions—commercial banks—which Congress thought should be subject to the one statute here at issue, the BHCA. Moreover, whether the Dimension banks' investment strategy for temporarily idle funds involves commercial paper, certificates of deposit, or Treasury bills (which are not commercial loans even

[40] Decision of the Comptroller of the Currency on the Applications of Dimension Financial Corporation to Charter 31 National Banks in 25 States, at 23 (May 9, 1984) (hereinafter "Comptroller's Decision").

[41] *Id.* at 20. Moreover, the Dimension holding company itself will be subject to Comptroller regulation as an "affiliate" of a national bank. *See* 12 U.S.C. § 481 (1982).

[42] In fact, the United States District Court for the District of Columbia has found that the Dimension system does not present any substantial issues under the BHCA. *Independent Bankers Ass'n* v. *Conover*, No. 84-3201, slip opinion (Feb. 27, 1985).

under the Board's new definition (*see* note 35 *supra*)), does not alter this absence of "evasion."[43]

The Board's variations on its evasion argument further undercut its legal position. In particular, the Board claims that "there is a significant likelihood that in practice . . . a nonbank bank . . . will be tempted to provide indirectly all of the services of a commercial bank." Pet. Br. at 22, 45. Prohibiting temptation is normally considered a religious function, not a justification for a continuing and pervasive expansion of regulatory authority. If this concern were sufficient to enlarge the Board's jurisdiction, there would be no limit to the eventual extent of the Board's financial regulation and no point in Congress enacting jurisdictional limitations. Rather than support the Board, this enforcement argument merely confirms that utilizing money market and interbank instruments does not constitute a violation of the Act, and that the Board is seeking to expand its jurisdiction for reasons unrelated to those instruments.

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[43] The Board's *amici* press the Board's "evasion jurisdiction" even more enthusiastically than the Board. Brief of Conference of State Bank Supervisors, *et al.* ("CSBS") as *Amici Curiae* at 24-25; Brief of Independent Bankers Association of America as *Amicus Curiae* at 14-15. *Amici* would confer on both the Board and the federal courts almost untrammelled power to attack "adroit and unscrupulous practices," and thus "insur[e] compliance with Congress' goals even when Congress muddies the waters." CSBS Brief at 25-26, *in part quoting Florida Department of Banking and Finance* v. *Board of Governors*, 760 F.2d 1135, 1143-44 (11th Cir. 1985), *cert. pending*, No. 85-193, 54 U.S.L.W. 3100.

Amici's argument erroneously assumes *ab initio* that institutions like Dimension are in fact commercial banks and that their exclusion from the Act's coverage therefore constitutes an "evasion." That argument ignores the clear evidence that Congress never intended the Act to cover institutions that do not make commercial loans, and that the Board itself recognized for years that Dimension's proposed investment activities do not constitute "commercial loans." There is nothing "adroit and unscrupulous" about doing what the law allows.

Similarly, the Board repeatedly suggests that the existence of limited-service banks like the Dimension system is at odds with or an evasion of the Douglas Amendment to the BHCA, 12 U.S.C. § 1842(d), citing the Court's recent decision in *Northeast Bancorp, Inc.* v. *Board of Governors*, 105 S. Ct. 2545 (1985). But like the Board's regulatory authority, the Douglas Amendment's scope is coterminous with the Congressional definition of a "bank" under the BHCA. The fact that the Douglas Amendment may prohibit ownership of certain banking institutions in more than one state does not answer the question of what those institutions are. Instead, the prohibition of the Douglas Amendment, like the reach of the Board's regulatory powers, is specifically limited to those institutions defined by Congress in section 2(c) of the Act.[44]

Furthermore, the current extent of lawful interstate banking, *consistent* with the Douglas Amendment, demonstrates that the Amendment certainly is not a blanket prohibition of interstate banking activities, as the Board and its *amici* suggest.[45] The Federal Reserve Bank of

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[44] The concept that an evasion power can be used to alter a statute's meaning, contrary to its express language, was taken to its most extreme form in the recent decision of the Eleventh Circuit in *Florida Department of Banking & Finance* v. *Board of Governors*, 760 F.2d 1135 (1985), *cert. pending*, No. 85-193, 54 U.S.L.W. 3100. The court there read the "commercial loan" limitation out of the BHCA entirely, a clearly invalid result. *United States* v. *Menasche*, 348 U.S. 528, 538-39 (1955).

[45] The proposed Dimension system once again exemplifies the overbreadth of the Board's action when measured against the underlying purpose of the Douglas Amendment "to retain local, community-based control over banking." *Northeast Bancorp, Inc.* v. *Board of Governors*, 105 S. Ct. at 2553. Dimension is not one of the "established banking giants in New York, California, Illinois, and Texas" seeking to extend its current business across state lines. *Id.* at 2549. Rather, Dimension is a new market entrant proposing a network of consumer banks heavily oriented to the needs of the specific communities where its proposed banks would be located and whose corporate boards would have a majority

[Footnote continued]

Atlanta in 1983 surveyed the extent of interstate banking activity and concluded that consistent with the Douglas Amendment, "banking organizations are providing financial services across state lines and have been doing so for some time."[46] Terming the amount of interstate activity "prodigious," the Atlanta Federal Reserve Bank found that "domestic banking organizations control at least 7,383 interstate offices and, if we include interstate offices of foreign banking organizations, the total reaches 7,840."[47] In *Northeast Bancorp*, this Court expressly recognized the existence of "growing competition from non-banking financial services that are not confined within state lines," noting that this was the very rationale of the state statutes the Court upheld in that case. 105 S. Ct. at 2553. Thus, the Douglas Amendment is an important piece in the regulatory framework, but it does not require or enable the Board to rewrite other provisions to reach non-BHCA banks.

As these facts and the very language of the statute demonstrate, Congress has determined that all the provisions of the BHCA, including the Douglas Amendment, should be triggered only where an institution receives demand deposits, including deposits of commercial enterprises, and engages in the business of lending those deposits back to commercial enterprises in the form of commercial loans. The Board cannot rewrite this Congressional definition either by pressing its own view that

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of their directors drawn from those very communities. Comptroller's Decision, *supra* note 40, at 2, 10-11. It should be noted that before approving this concept as fully warranted by the needs of the particular communities involved (*id.* at 23), the Comptroller specifically reviewed the banking laws of each and every state in which Dimension proposes to operate. *Id.*, Appendix.

[46] Whitehead, "Interstate Banking: Taking Inventory," *Economic Review* 1 (May 1983) (J.A. 156A).

[47] *Id.* at 20, 18 (J.A. at 172A, 170A).

the purposes of the Act would now be better served by such a redefinition and the resulting expansion of its jurisdiction, or by invoking an alleged power to prevent "evasions" by the very institutions Congress intended to exclude from the Act's provisions.

III. DECISIONS REGARDING THE SHAPE OF FINANCIAL REGULATION ARE FOR CONGRESS, AND THE BOARD SHOULD NOT BE PERMITTED TO ARROGATE THAT POWER.

The Board's arguments ultimately come down to its perceived need for more jurisdiction to deal with changes in the financial marketplace as it deems fit. However, the United States Government and other individual federal agencies have different views on the shape of financial regulation, and Congress is the constitutional arbiter for resolving these policy differences. If the Board were permitted to implement its own policy view through the simple expedient of a purported jurisdictional "interpretation," the legislative process would be distorted and congressional responsibility usurped. Even full "deference" to an expert agency cannot authorize that agency's assumption of major policy decisions properly made by Congress. *Bureau of Alcohol, Tobacco & Firearms* v. *Federal Labor Relations Authority*, 464 U.S. 89, 97 (1983).

The essentially legislative nature and intent of the Board's action in attempting to redefine "commercial loans" is demonstrated by the Board's statement that its current effort to halt change in the financial marketplace was necessary "in order to avoid the preemption of Congressional discretion." Pet. App. at 61a. In 1983, the Board proposed for introduction into Congress a bill that would have imposed a moratorium on any further developments in the banking system through broadening the definition of "bank" in the BHCA. Chairman Volcker testified that "[w]e do think that the enactment of a temporary moratorium will give you [Congress] a little

breathing room."[48] Congress did not enact the Board's requested moratorium, and Senator Garn, Chairman of the Senate Banking Committee, among others, expressly disapproved of the Board's proposal.[49]

Congress having proven so intractable, the Board promulgated the Regulation Y amendments shortly thereafter to provide Congress "the discretion" that apparently Congress does not want or, more accurately, has not exercised in the particular manner urged by the Board. But the Board is not Congress, and the Board cannot preserve or direct Congressional discretion by limiting market developments in areas where Congress has not granted it the authority to act.[50] As stated by the FDIC in response to the Board's Dreyfus Letter:

> We firmly believe that Congress is the appropriate authority to reassess the statutory distinctions among banking institutions, thrifts, securities firms, other providers of financial services and commercial firms in general, and to resolve the underlying question of

[48] *Moratorium Legislation and Financial Institutions Deregulation: Hearings on S.1532, S.1609 and S.1682 Before the Senate Comm. on Banking, Housing, and Urban Affairs*, 98th Cong., 1st Sess. 140 (1983).

[49] *See id.* at 83 (remarks of Senator Garn). The Administration also opposed the Board's moratorium. *Id.* at 65 (testimony of Secretary Regan).

[50] Courts in the past have had to guard against the Board ignoring plain statutory language to further its own notions of the public interest. *See American Bankers Association* v. *Connell*, 686 F.2d 953, 954 (D.C. Cir. 1979) (striking down Board regulations whose effect was "to rewrite the language of statutes"); *Patagonia Corp.* v. *Board of Governors*, 517 F.2d 803, 813 n.11 (9th Cir. 1975) ("Congress surely did not intend that the Board would be empowered to expand or constrict the statutory definition . . . in accordance with the Board's conception of regulatory needs.") *Western Bancshares, Inc.* v. *Board of Governors*, 480 F.2d 749, 752 (10th Cir. 1973) (striking down Board action that court determined was tantamount to legislating, "a function vested exclusively in the legislative branch").

> the activities in which banks and bank holding companies shall be permitted to engage.

J.A. at 91A.

"The underlying question" noted by the FDIC has in fact been the subject of an ongoing policy debate among federal regulators and others throughout the banking and financial services industry. While the Board speaks darkly of the "possibly dangerous alteration of the banking structure" (Pet. Br. 24), the Comptroller and the FDIC have expressed the view that increased competition by new providers of financial services is in the public interest.[51] The Assistant Attorney General for the Antitrust Division expressed the similar view in 1983 that "increasing the potential for new entry" would aid competition in the banking industry and concluded that "the prevention of undesirable levels of concentration can and should be addressed through the antitrust laws, not through blanket prohibitions on interstate banking."[52] Indeed, even one of the Board's Governors, Gov-

[51] The Comptroller's Office in 1980 issued a policy statement affirming the "view that the convenience and needs of communities for banking services are best served by a high degree of competition and with the Office's view that qualified persons should have the maximum opportunity to organize and operate a national bank." 45 Fed. Reg. 68603, 68603 (Oct. 15, 1980). The Comptroller found the chartering of the Dimension banks consistent with this policy. Comptroller's Decision, *supra* note 40, at 23.

See also Statement of William M. Isaac, Chairman, FDIC, *Competitive Equity in the Financial Services Industry: Hearings on S.2181 and S.2134 Before the Senate Comm. on Banking, Housing, and Urban Affairs*, Pt. III, 98th Cong., 2d Sess. 1274, 1280 (1984) (supporting general framework of deregulation and "favor[ing] a system without artificial barriers to lock firms into and out of markets").

[52] Testimony of William F. Baxter, Assistant Attorney General, Antitrust Division, Department of Justice, *Financial Services Industry-Oversight: Hearings Before the Senate Comm. on Banking, Housing, and Urban Affairs*, 98th Cong., 1st Sess. 408, 414 (1983).

ernor Rice, has admitted that limited-purpose banks "would have the attractive competitive feature of requiring de novo entry into new markets. New entrants would have to compete for market share. . . ." [53]

Moreover, increased competition does not threaten the health of existing banks. As Governor Rice further acknowledged, "[c]ontrary to frequently expressed fears, de novo entry by large corporations does not harm the existing banks in a market." [54] This position was confirmed in a recent report by the staff of the Federal Reserve Bank of Chicago. According to this report, "the banking industry has shown an amazing degree of resiliency in the face of" competition from nonbanking providers. The authors concluded that fears of "immediate danger to the banking industry . . . are unwarranted." [55]

Congress thus has before it a variety of views on which changes in banking and financial services should be encouraged, which should be deterred, and how responsibility for regulation of the country's financial services industry should be allocated. Congress has actively monitored this industry in the past and has acted when it has determined that changes in the governing regulatory structure are necessary. Congress has enacted three major banking statutes in recent years,[56] and its close supervision of developments in the industry continues. In this session alone at least ten bills have been introduced concerning financial regulation.[57]

[53] E. J. Rice, Remarks before the National Association of Urban Bankers, "Progress Towards Interstate Banking" 9-10 (June 21, 1984).

[54] *Id.* at 10. New entrants may also be able to fill needs not met by existing institutions. For example, even in Iowa, a state that previously has strongly favored local banks, a recent editorial in the Des Moines Register suggested that restrictions on interstate banking may be responsible for the severely limited availability of capital in Iowa. The editorial concluded: "Perhaps a branch of a major financial institution with a diversified base could serve the community better than a local bank." Des Moines Register, Aug. 1, 1985, at 10A, col. 1.

[55] Pavel & Rosenblum, *supra* note 39, at 15.

The Court has made clear in recent years that policy questions of the type raised by the Board in this case must be resolved by Congress. Whatever the dictates of wise policy, "that policy must be implemented by Congress." *BankAmerica Corp.* v. *United States,* 462 U.S. at 133. In particular, "[i]f changes in economic factors or considerations of public policy counsel" the extension of a statute's reach, "it is a simple matter for Congress to say so clearly." *Id. Accord United States* v. *Lorenzetti,* 104 U.S. 2284, 2292 (1984). Similarly, if developments in the marketplace have really resulted in any problems in the BHCA's current definition of a "bank," the power to address that purported problem resides solely in Congress, for "this defect—if defect it is—is inherent in the statute as written, and its correction must lie with Congress." *Sedima, S.P.R.L.* v. *Imrex Co.,* 105 S. Ct. 3275, 3287 (1985).

Congress, having established the bounds of the Board's jurisdiction under the BHCA through the definition of a "bank," necessarily withheld from the Board the power to redefine that term. Because the Board cannot arrogate the responsibility to expand its own jurisdiction, the Board should not now be allowed by administrative fiat to compel affirmative Congressional action to restore a

[56] Garn-St Germain Depository Institutions Act of 1982, Pub. L. No. 97-320, 96 Stat. 1469; Depository Institutions Deregulation and Monetary Control Act of 1980, Pub. L. No. 96-221, 94 Stat. 132; Financial Institutions Regulatory and Interest Rate Control Act of 1978, Pub. L. No. 95-630, 92 Stat. 3641.

[57] H.R. 15; H.R. 20; H.R. 52; H.R. 688; H.R. 1276; H.R. 1514; H.R. 1923; H.R 2099; H.R. 2212; H.R. 2707.

regulatory *status quo* upset by the Board's action.[58] The Board's current effort to do precisely that is particularly inappropriate in view of the fact that the Board's new legal interpretation of the BHCA is an abrupt and major departure from previous constructions of the Act and, therefore, will have severe consequences for those who relied on the earlier constructions, as well as consequences for other agencies and the public which cannot readily be undone by Congress. *See BankAmerica Corp.* v. *United States*, 462 U.S. at 132; *J. W. Bateson Co.* v. *United States ex rel. Board of Trustees*, 434 U.S. 586, 592-94 (1978).

CONCLUSION

For the foregoing reasons, respondents Dimension Financial Corporation, *et al.* respectfully request that the judgment of the court of appeals be affirmed.

Respectfully submitted,

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[58] The full extent of this problem is illustrated by the fact that the Board's amended regulation would require affirmative Congressional action even if Congress merely wanted to acquiesce in the Board's position. Specifically, any BHCA "bank" is required by the Act to obtain FDIC insurance, 12 U.S.C. § 1842(e) (1982), but the Board's new definition of "bank" would include certain institutions, such as some industrial loan companies, which are *ineligible* for FDIC insurance. Remarkably, the Board "resolved" this dilemma by dictating to Congress a two-year deadline in which to pass new legislation ending the statutory conflict created by the Board's amended regulation. Pet. App. 44a.

(7)

No. 84-1274

In The

Supreme Court of the United States

October Term, 1984

Board of Governors of the
Federal Reserve System, Petitioner

v.

Dimension Financial Corporation, *et al.*

**ON WRIT OF CERTIORARI TO THE
UNITED STATES COURT OF APPEALS
FOR THE TENTH CIRCUIT**

**BRIEF FOR RESPONDENTS
AMERICAN FINANCIAL SERVICES
ASSOCIATION, *ET AL.***

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IN THE

Supreme Court of the United States

OCTOBER TERM, 1984

No. 84-1274

BOARD OF GOVERNORS OF THE
FEDERAL RESERVE SYSTEM, PETITIONER

v.

DIMENSION FINANCIAL CORPORATION, *et al.*

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE TENTH CIRCUIT

BRIEF FOR RESPONDENTS AMERICAN FINANCIAL SERVICES ASSOCIATION, *ET AL.*

QUESTION PRESENTED

Whether the court of appeals correctly concluded that the Federal Reserve Board exceeded its authority under the Bank Holding Company Act, as amended, when it defined a "bank" as an institution that, among other things, accepts any deposit "with transactional capability that, *as a matter of practice*, is payable on demand," and thereby brought within the statute numerous financial institutions deliberately excluded by the Congress when it amended the law in 1966 to define "bank" as any institution that, among other things, accepts "deposits that the depositor has *a legal right* to withdraw on demand" (emphasis supplied).[1]

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[1] A parallel issue, involving the Board's definition of the term "commercial loan" as part of the definition of "bank" in the BHC Act, is addressed by respondent Dimension Financial Corporation in its brief on the merits.

STATEMENT OF THE CASE

Introductory Statement

The issue presented is whether the Federal Reserve Board (the "Board") lawfully may adopt an expansive definition of "bank" in the Bank Holding Company Act (the "BHC Act" or "Act")—a key term, jurisdictional in function if not in name, already defined by Congress in the statute and periodically narrowed in a series of legislative amendments. Rather than commit the meaning of "bank" to the Board's interpretive discretion, or leave it to the Board to employ "expertise" in fleshing out the statutory scheme, Congress has reserved—and repeatedly exercised—the authority to prescribe the proper meaning of "bank," and hence to determine the scope of the BHC Act.

By its rule-making order at issue here, amending its Regulation Y, the Board has greatly expanded the coverage of the BHC Act. The Board's action has brought within the statute hundreds of longstanding financial institutions, such as industrial loan companies and industrial banks, that never previously were deemed "banks" under the Act, and that Congress purposely excluded from the "bank" definition in the 1966 amendments to the BHC Act. Thus, parent institutions that suddenly have become "bank holding companies" under the BHC Act by virtue of the Board's rule-making order face an onerous choice. They must either (a) divest their "banks," as newly defined, or (b) divest all nonbanking activities forbidden to holding companies under the Act, no matter how lawful and proper such activities were before the Board promulgated its order.

Similarly, institutions suddenly brought under the Act as "banks" by virtue of the Board's expansion of Regulation Y now must divest themselves of either (i) their NOW accounts, never previously deemed "demand" deposits under the Act, or (ii) their "commercial loan" activities, including the purchase of traditional money-market instruments (such as commercial paper and certificates of deposit), never previously deemed "commercial loans." Alternatively, affected institutions must

obtain insurance from the Federal Deposit Insurance Corporation (the "FDIC")— even if, as State-chartered entities, they already have insurance with carriers approved and authorized by applicable State law.

In Section 2(c) of the BHC Act, Congress has defined a "bank" as "any institution . . . which (1) accepts deposits that the depositor has *a legal right* to withdraw on demand, and (2) engages in the business of making commercial loans. . . ." 12 U.S.C. § 1841(c) (1982) (emphasis supplied). By its rule-making order, the Board adopted a regulatory "definition" of the "legal right" prong of the statutory definition:

> "any deposit with transactional capability that, *as a matter of practice,* is payable on demand and that is withdrawable by check, draft, negotiable order of withdrawal, or other similar instrument" (R. 1744) (emphasis supplied).

The Board's definition reaches numerous thrift institutions never previously treated as "banks" under the BHC Act, simply because those institutions offer their customers NOW accounts. These are interest-bearing savings accounts maintained by natural persons and nonprofit corporations, but denied to all commercial entities, from which the account holder has a right of withdrawal by negotiable draft as well as by personal presentation of his passbook at the teller's window. The members of respondent American Financial Services Association and the other respondents that join in this Brief are swept up in the BHC Act's comprehensive regulatory regime by virtue of their NOW account offerings, and they assail that aspect of the Board's regulatory "definition."

Contrary to the Board's assertion (Pet. 3), the financial institutions represented by the respondents joining in this brief are not "largely indistinguishable from banks," and they most certainly are not "fully regulated by the Comptroller of the Currency pursuant to the National Bank Act." Rather, they are, for the most part, State-chartered industrial loan companies,

industrial banks, and industrial loan corporations.[2] These institutions have been in existence for many years before the Board's promulgation of its revised Regulation Y; they were established, and (as to those that are now holding company subsidiaries) acquired by corporate entities in entire good faith, at a time that it was unquestionably lawful to do so.

[2] The terms "industrial bank," "industrial loan company," and "industrial loan corporation" are interchangeable. *See, e.g., Norfolk Industrial Loan Ass'n* v. *United States*, 70-2 U.S. Tax. Cas. (CCH) ¶ 9,527, at 84,254 (E.D. Va. 1970); Booth, *Industrial Banks as Thrift Institutions*, 1981, at 11 (NCFA Research Services, Jan. 1982).

Respondent American Financial Services Association ("AFSA") is the national trade association of companies engaged in the consumer financing business. It is the nation's largest trade association serving the consumer finance industry. AFSA was organized in 1916, and until 1983 operated as the National Consumer Finance Association. Currently, AFSA represents over 550 companies engaged in the extension of consumer credit through 12,000 offices nationwide. AFSA's member companies serve over 20 million United States households, and have over $100 billion in credits outstanding. Member companies range from single-office, independently owned companies to national organizations that operate hundreds of offices around the country. A roster of member companies has been filed with the Clerk of the Court.

Respondent First Bancorporation is a Utah bank holding company whose application to acquire a Utah industrial loan company triggered the *Beehive* proceeding, described in the text of this brief.

Respondent Household Finance Corporation ("HFC") makes cash loans directly to consumers throughout the United States and elsewhere, including residential equity loans secured by second mortgages on real estate. HFC operates through various institutions throughout the country, including numerous industrial banks and industrial loan corporations chartered in Colorado, Utah, Kansas, and Iowa. HFC is a wholly owned subsidiary of Household International, Inc. ("International"), which, through other subsidiaries, is engaged in various activities—merchandising (such as the ownership and operation of the Vons Grocery chain in southern California, T.G.&Y. stores, and other operations); manufacturing (such as King-Seeley Thermos Company, Schwitzer power components, Eljer plumbing products and other building products, tools, and consumer products); and transportation (including ownership and operation of National Car Rental System, Inc.). These lines of business, which are classified under the BHC Act as nonbanking activities, are impermissible for International if HFC is a "bank holding company" for purposes of the Act.

(footnote continues)

The "demand" deposit prong of the Board's regulatory "definition" has its genesis in the Board's adjudicative order in *First Bancorporation*, 68 Fed. Res. Bull. 253 (1982), and in the subsequent reversal of that order by the United States Court of Appeals for the Tenth Circuit in *First Bancorporation* v. *Board of Governors of the Federal Reserve System*, 728 F.2d 434 (10th Cir. 1984). That proceeding, which is commonly known as the *Beehive* case, provided the precedent on which the court of appeals below relied in setting aside the "demand" deposit prong of the Board's rule-making order here under review. Accordingly, the respondents joining in this Brief will first discuss the *Beehive* case, and then will turn to those aspects of the Regulation Y rule-making proceeding and order that are relevant to the "demand" deposit branch of the present controversy.

The Beehive Proceeding

In February 1979, Respondent First Bancorporation, a Utah company that owns Utah Firstbank (BR 10, 14),[3] applied to the Board for approval under the BHC Act to engage *de novo* in the business of operating an industrial loan company through Foothill Thrift & Loan Company ("Foothill") (BR 268, 272). Under Utah law, Foothill was authorized to operate as an industrial loan company and, in the course of that business, to

(footnote continued)

Respondent The Colorado Industrial Bank Association ("CIBA") is an association of industrial banks chartered in the State of Colorado. CIBA numbers among its membership petitioners Fort Lupton Industrial Bank, Monroe Industrial Bank, Castle Rock Industrial Bank, Ark Valley Industrial Bank, Household Weld County Industrial Bank, Household Lamar Industrial Bank, Household Alamosa Industrial Bank, Household Valley Industrial Bank, and Household Salida Industrial Bank. (The "Household" industrial banks are subsidiaries of respondent HFC.) By virtue of the Board's order here under review, each of these Colorado institutions has become, or is threatened with becoming, a "bank" for purposes of the Act by virtue of its present or future offerings of NOW accounts.

[3] "BR" means the "Beehive Record" of the administrative proceeding before the Board involving First Bancorporation. By separate motion, respondents herein have proposed to lodge a copy of that record with the Clerk of this Court.

issue thrift certificates and thrift passbook certificates, but not to "create any liability due on demand." On April 2, 1979, the Federal Reserve Bank of San Francisco advised that it had no objection to First Bancorporation's commencing the proposed industrial loan activities through Foothill (BR 284).

NOW accounts. On December 31, 1980, the State of Utah's Department of Financial Institutions issued its Regulation No. 2, authorizing Utah industrial loan companies to offer NOW accounts (BR 162). The State of Utah thereby joined a number of other jurisdictions, both State and federal, that have authorized banks and thrift institutions to offer NOW accounts. The regulations promulgated by Utah directed: "All NOW drafts must contain a provision reserving the right of the issuing industrial loan corporation to require 30 days' notice before making payment" (BR 163). In April 1981, in response to Foothill's application, Utah authorized Foothill to offer NOW accounts subject to compliance with applicable State regulations (BR 152).

The Beehive application. In August 1981, First Bancorporation applied to the Board to acquire Beehive Thrift & Loan Company ("Beehive"), another Utah industrial loan company (BR 1). Thereafter, First Bancorporation advised the Board that Beehive would offer NOW accounts in the manner of Foothill, and furnished a description of Foothill's NOW accounts, together with a specimen of a Foothill NOW account draft with its legend reserving the right to require 30 days' prior notice of withdrawal (BR 164; App. A to this Brief).

It merits emphasis that neither the Foothill nor the Beehive application filed by First Bancorporation implicated any issue of interstate banking under the Douglas Amendment. First Bancorporation, as noted, was (and is) a Utah bank holding company; both Foothill and Beehive were Utah industrial loan companies; Foothill offered, and Beehive proposed to offer, NOW accounts in full conformity with governing Utah statutes and regulations. There was no suggestion that either Foothill or Beehive had been created, or their financial activities tailored, to "evade" any provision of the BHC Act or of any other law.

The Board's Beehive ruling. On March 12, 1982, the Board issued an order that in form conditionally approved First Bancorporation's proposed acquisition of Beehive, but in practical effect denied it. The Board conceded that in its Regulation Y as it then stood, the administrative agency already had determined that a bank holding company's operation of an industrial loan company in the manner authorized by State law was a permissible nonbank activity under the BHC Act, "so long as the [acquired] institution does not both accept demand deposits and make commercial loans" (BR 256) (citing 12 C.F.R. § 225.4(a)(2)). The Board did not dispute that Beehive had been, and would continue to be, operated in accordance with Utah law.

However, the Board determined that Beehive's proposed NOW accounts would constitute deposits that the customer has a "legal right" to withdraw on "demand." Accordingly, the Board said, Beehive (once acquired) could not both offer NOW accounts and engage in the business of making commercial loans (BR 258).

In the letter transmitting its decision to First Bancorporation, the Board directed that "in order to comply with" the BHC Act, Foothill, acquired by First Bancorporation with the Board's unconditional permission three years previously, now "should conform" to the policies and directives announced for the first time by the Board in its *Beehive* ruling (BR 263). Thereafter, the Board forwarded copies of its *Beehive* decision to various bank holding companies around the country, coupled with a pointed suggestion that the recipients should bring the activities of their subsidiaries offering NOW accounts into conformity with the Board's *Beehive* ruling. *See* 728 F.2d at 435. Thus, the Board effectively treated its *Beehive* ruling as a *de facto,* policy-making rule, immediately applicable to bank holding companies throughout the nation.

On petition for review of the Board's conditional *Beehive* order and its letter directive to First Bancorporation concerning

the NOW-account activities of Foothill, the court of appeals set aside the Board's conditional order:

> "We need look no further than the Act's definition of a 'bank' to resolve this dispute. As the Supreme Court has announced, 'There is, of course, no more persuasive evidence of the purpose of a statute than the words by which the legislature undertook to give expression to its wishes.' . . . As mentioned, section 2(c) of the Act defines 'bank' as an institution which makes commercial loans and 'accepts deposits that the depositor has *a legal right* to withdraw on demand.' 12 U.S.C. § 1841(c) (emphasis added). Utah law specifically proscribes industrial loan companies from accepting demand deposits, requiring instead that the companies reserve the legal right to demand notice prior to withdrawal. There is therefore no legal right of withdrawal on demand." 728 F.2d at 436 (citations omitted).

Although the Board sought rehearing in the court of appeals (which was denied), and obtained an extension of time within which to apply for a writ of certiorari, no petition for the writ was filed.[4]

[4] With regard to respondent First Bancorporation, the doctrine of collateral estoppel bars the Board's present effort to relitigate whether NOW accounts are, for purposes of the BHC Act, "demand deposits" when offered pursuant to State law by industrial loan companies chartered in States that do not authorize such companies to offer demand deposits. As this Court recently held, estoppel applies "in a case where the government is litigating the same issue arising under virtually identical facts against the same party," so as to prevent the government "from relitigating the . . . issue" previously decided in favor of the private party. *United States* v. *Stauffer Chemical Co.*, ____ U.S. ____, ____, 104 S. Ct. 575, 580 (1984).

Significantly, the Board has not attempted to identify any "intervening change in the applicable legal context" that might call into question the propriety of issue preclusion as to First Bancorporation. Nor does it appear that any other recognized exception to the general rule of issue preclusion is present here. *See* Restatement, Second, Judgments § 28 (1982).

The Regulation Y Proceeding

On May 19, 1983, while *Beehive* was pending before the court of appeals, the Board announced its intention to revise Regulation Y and invited public comments (R. 203-88). The sole authority advanced by the Board in support of its proposed "demand" deposit definition was its decision in *Beehive* (Pet. App. 21a).

The Board received extensive comment, much of it opposed to the proposed definition of "bank". One or both of the "demand" deposit and "commercial loan" prongs were the subject of adverse commentary from, among others, the Comptroller of the Currency (R. 440), the FDIC (R. 477), and the Federal Reserve Banks of Atlanta (R. 355), San Francisco (R. 312), and Chicago (R. 370). Nonetheless, by rule-making order issued December 29, 1983, the Board adopted its proposed revisions of Regulation Y, unaltered in material part, effective February 6, 1984.

On February 21, 1984, as noted, the court of appeals overturned the Board's adjudicative order in *Beehive*. The Board took no steps either to secure a stay of the *Beehive* ruling or to modify its revised Regulation Y in light of that ruling.

On September 24, 1984, the court of appeals below set aside the Board's "definitions" in the revised Regulation Y. 744 F.2d 1402 (Pet. App. 1a). Concerning the "demand" deposit prong of the Board's rule-making definition, the court adhered to its earlier decision in *Beehive*, *id.* at 1404 (Pet. App. 4a). The court carefully considered the Board's arguments advanced in support of its proposed definitions, *id.* at 1410 (Pet. App. 18a), and gave due cognizance to the doctrine that "accords deference to regulatory agencies in their implementation of statutory provisions," *id.* at 1410 (Pet. App. 16a).

On February 6, 1985, the Board filed its petition for writ of certiorari, as "authorize[d]" by the Office of the Solicitor General, but without that Office's participation or approval of the merits of the Board's position. On February 14, 1985, the court of appeals denied the Board's motion to stay the mandate. No stay of that order, or of the court of appeals' judgment, was sought in this Court.

Administrative Stays of the Revised Regulation Y

In tacit recognition of the substantial burdens imposed by its order, the Board announced on February 3, 1984, three days before the original effective date of Regulation Y, that upon request it would grant a six-month "grace period," until August 6, 1984, for registration and compliance with the Act—but only to companies that acquired their "banks" prior to December 10, 1982, and that became "bank holding companies" as a result of the Board's order.[5] At the same time, the Board announced that it would exempt from its revised Regulation Y those "companies that, before December 10, 1982, acquired state chartered savings and loan associations, the deposits of which are privately insured under state law, provided that these institutions limit their activities to those permissible for federal thrift institutions under the Home Owners' Loan Act" (R. 1879).

On July 10, 1984, while the judicial review proceeding was pending before the court of appeals, the Board further extended its deadline for registration and compliance under its revised Regulation Y to December 31, 1984. On December 20, 1984, the Board extended indefinitely the date for registration and compliance, this time pending resolution of the legal issues concerning the "bank" definition "by Congress or the courts" (AFSA Br. App. B).

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[5] The date of December 10, 1982 marks the issuance of the Board's Dreyfus letters, to be discussed in the brief of Dimension Financial Corporation. The administrative "grace period" presumably had its origin in the fact, acknowledged by the Board's general counsel in a memorandum to the Board of Governors, that "a number of . . . companies may, prior to the date . . ., have acquired nonbank banks *on the basis of prior Board statements regarding the definition of bank in the Act*" (R. 1446) (emphasis supplied). Although the Board at times hints that its "demand" deposit definition reflects no change in interpretation of the BHC Act, the Board's general counsel, in the same memorandum, told the Board:

> "The proposed definition[ ] of demand deposits . . . would cover a number of institutions, particularly industrial banks and industrial loan companies, that, *until the Board's Beehive . . . action* [ ], were not covered by the Act" (R. 1443-44) (emphasis supplied).

(footnote continues)

SUMMARY OF ARGUMENT

The Board's rule-making redefinition of the "demand" deposit prong of "bank" is contrary to both the plain language of the BHC Act and Congress' stated objective in amending the statutory language in 1966. The Senate Committee report accompanying the 1966 amendments stated that "the bill redefines 'bank' . . . so as to exclude institutions like industrial banks" that offered accounts that "in practice" were payable on demand. Nonetheless, the Board has endeavored to bring back within the coverage of the Act the very institutions that Congress deliberately determined should not be included. The Board's action is particularly egregious where, as here, Congress has reserved to itself—and frequently exercised—the authority to define the key terminology in the statute rather than remit that authority to the Board.

The Board's abrupt declaration that NOW accounts are demand deposits reverses its earlier settled position that NOW accounts are savings deposits. The Board's rule-making action runs counter both to the federal statutes that have authorized the introduction of NOW accounts throughout the country, and to the Board's past administrative actions—its prior decisions under the BHC Act and its key regulations that govern reserve requirements and interest-rate limitations for depository institutions.

The question of a proper "bank" definition, and hence of the proper reach of the BHC Act, is for Congress to decide—not the Board. The Board has conceded this by applying repeatedly to Congress for a legislative remedy. That Congress thus far has declined to respond does not alter the proper allocation of legislative responsibilities, nor does it empower the Board to assume Congress' role.

(footnote continued)

Elsewhere, in its press release accompanying the promulgation of the revised Regulation Y, the Board adverted to its "hardship" procedure for the benefit of companies "that acquired nonbank banks prior to December 10, 1982, on the basis of a narrow interpretation of the commercial loan *or demand deposit* definitions *in effect before that time*" (R. 1627) (emphasis supplied).

ARGUMENT

I. THE BOARD'S REDEFINITION OF "DEMAND" DEPOSITS CONTRAVENES THE LANGUAGE OF THE BANK HOLDING COMPANY ACT AND THE INTENT OF CONGRESS

The Board's admitted purpose in rewriting the statutory definition of "bank" was to enlarge its jurisdiction to reach financial institutions that previously lay beyond the BHC Act. Contrary to the Board's skillfully conveyed suggestion (*see* Pet. Br. 24 & n.17), the vast majority of financial institutions affected by the revised Regulation Y are not the so-called "nonbank banks" newly chartered by the Comptroller of the Currency or applying for charters from the Comptroller. Rather, most of the institutions swept up into the BHC Act as "banks" under the revised Regulation Y are long-existing industrial banks and similar thrift institutions that offer NOW accounts (*see* Pet. App. 32a).

NOW accounts are interest-bearing savings accounts, maintained by natural persons and nonprofit corporations but not by commercial entities, from which the customer may make withdrawals by negotiable draft as well as by personal presentation of his passbook. NOW account customers plainly do not have the *legal right* to withdraw their NOW account deposits on demand. By law, any institution that offers NOW accounts *must* reserve the right to require written notice before the customer withdraws his funds. To overcome this hurdle, the Board simply eliminated the statutory term "legal right" from its regulatory definition of "bank." In so doing, the Board flouted the plain language and unambiguous legislative history of the BHC Act. The Board thereby expanded its regulatory powers to reach industrial banks and similar institutions that Congress deliberately excluded from the BHC Act when it amended the statutory definition of "bank" in 1966.

A. The Board's Revised Definition Contravenes the Plain Meaning of the BHC Act, Inasmuch as NOW Account Holders Do Not Have the "Legal Right" To Make Withdrawals on Demand

There is "no more persuasive evidence of the purpose of a statute than the words by which the legislature undertook to give expression to its wishes." *United States* v. *American Trucking Association,* 310 U.S. 534, 543 (1940). Where the words of a statute are unambiguous, this Court repeatedly has required that the "plain meaning" of the statutory language be followed. *See Potomac Electric Power Co.* v. *Director,* 449 U.S. 268, 283-84 (1980); *United States Railroad Retirement Board* v. *Fritz,* 449 U.S. 166, 176 (1980); *Diamond v. Chakrabarty,* 447 U.S. 303, 315-18 (1980); *United States v. Oregon,* 366 U.S. 643, 648 (1961); *McDonald v. Thompson,* 305 U.S. 263, 266 (1938).

The "plain meaning" doctrine in statutory construction is no less applicable when the statute in question prescribes a regulatory regime to be implemented by an administrative agency. As this Court said in *Chevron, USA, Inc.* v. *Natural Resources Defense Council, Inc.,* ____U.S.____, ____, 104 S. Ct. 2778, 2781-82 (1984):

> "When a court reviews an agency's construction of the statute which it administers, it is confronted with two questions. *First, always, is the question whether Congress has directly spoken to the precise question at issue.* If the intent of Congress is clear, that is the end of the matter; for the court, as well as the agency, must give effect to the unambiguously expressed intent of Congress." (Footnote omitted) (emphasis supplied).

Added the Court:

> "The judiciary is the final authority on issues of statutory construction and must reject administrative

constructions which are contrary to clear congressional intent." *Id.* at 2782 n.9 (citations omitted).[6]

Here, the language of the BHC Act admits of no ambiguity, either as a general matter or insofar as it relates to NOW accounts. Section 2(c) of the Act defines a bank, *inter alia,* as an institution that "accepts deposits that the depositor has *a legal right* to withdraw on demand" (emphasis supplied). A NOW account customer does not have the "legal right" to withdraw his funds on demand, because the depository institution has reserved its own legal right to require advance notice before permitting the depositor to withdraw his funds.

Long before the Board promulgated its revised Regulation Y, courts and commentators uniformly concluded that where financial institutions reserve the right to require prior notice of withdrawals from accounts, account holders do not have a "legal right" to withdraw their money on demand. As a leading authority on the Act has written, NOW accounts are not "demand" deposits for the purposes of the Act, even if they are, "as a matter of practice, paid on demand"—because "the depository institution is not obliged as a matter of legal right" to pay on demand. P. Heller, *Federal Bank Holding Company Law* 6-7 n.21 (1976).[7]

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[6] As this Court said in *Barlow* v. *Collins,* 397 U.S. 159, 166 (1970):

> "[S]ince the only or principal dispute relates to the meaning of the statutory term, the controversy must ultimately be resolved, not on the basis of matters within the special competence of the Secretary, but by judicial application of canons of statutory construction. . . . 'The role of the courts should, in particular, be viewed hospitably where . . . the question sought to be reviewed does not significantly engage the agency's expertise. "[W]here the only or principal dispute relates to the meaning of the statutory term" . . . [the controversy] presents issues on which courts, and not [administrators], are relatively more expert' " (citations omitted).

[7] *Accord, Pennsylvania Bankers Association* v. *Secretary of Banking,* 481 Pa. 332, 392 A.2d 1319, 1321-22 (1978) (whether or not a bank exercises its right to require notice before paying a NOW draft, "such an instrument is obviously not 'payable on demand' "); *Savings Bank* v. *Bank Commissioner,* 248 Md. 461, 237 A.2d 45, 53 (1968) (notice requirement "negates the assumption that deposits made in accounts subject to withdrawal by check

(footnote continues)

Respondents are aware of no State—and the Board has identified none—where financial institutions offer NOW accounts without reserving the right to require notice prior to withdrawal. *See, e.g.,* Utah Code Ann. 7-1-103(21); Utah Dept. of Financial Institutions Regulation No. 2 (1980); Colorado Rev. Stat. § 11-22-108(1); Ind. Code Ann. § 28-5-1-12 (Supp. 1982); Nebraska Dept. of Banking and Finance Rule 73. Given the longstanding prohibition on the payment of interest on demand deposits, *see* 12 U.S.C. § 371a, the right to require notice of withdrawal is a necessary feature not only of NOW accounts, but of *all* interest-bearing accounts, no matter whether they are accessible by check or other negotiable instrument. *See, e.g.,* 12 C.F.R. §§ 217.1(e) & 329.1(e)(2) (1982).

The Board argues that NOW account customers do have a "legal right" to withdraw their deposits on demand, because they are free to make withdrawals *until* the financial institution actually invokes its right to require notice of withdrawal (Pet. Br. 14-15). In other words, the Board argues, the customer has a "legal right" to withdraw funds from a NOW account until the financial institution exercises its superseding "legal right" to refuse to permit that withdrawal.[8] But a "legal right" exists only where its possessor is entitled to a judicial remedy to enforce it.[9] If a customer had the legal right to withdraw NOW account funds on demand, he could sue an institution that refused to

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(footnote continues)

can be characterized as demand deposits"); Comment, *The Negotiable Order of Withdrawal (NOW) Account,* 14 B.C. Indus. & Com. L. Rev. 471, 486, 487 (1973) (although NOW accounts may "in practice" be paid on demand, they are not demand deposits because the bank retains the authority to require notice prior to withdrawal).

[8] This argument is a *post hoc* concoction of Board counsel, and as such should be summarily dismissed. *See, e.g., Securities Industry Ass'n* v. *Board of Governors,* ____U.S.____, 104 S. Ct. 2979, 2983 (1984) ("it is the administrative official and not appellate counsel who possesses the expertise"). Board counsel first presented the argument in the Board's petition for rehearing in *Beehive.* Thus, the argument did not surface until long after the Board had promulgated its revised Regulation Y.

[9] 3 W. Blackstone, *Commentaries* *23, *109; *Marbury* v. *Madison,* 5 U.S. (1 Cranch) 137, 162-68 (1803); *see Greek Catholic Congregation* v. *Plummer,* 347 Pa. 351, 32 A.2d 299, 301 (1943); *In re Folwell's Estate,* 68 N.J. Eq. 728, 62 A. 414, 415 (1905).

allow withdrawal. Yet a financial institution is legally entitled to refuse to honor any NOW draft simply by requiring advance notice at the time the NOW draft is presented for payment. In such an instance, the customer cannot bring an action for damages or require the institution to allow him to withdraw his NOW account funds; he has no "legal right" to withdraw his funds on demand.

Equally unconvincing is Board counsel's suggestion that NOW account customers somehow have a "legal right" to withdraw their funds on demand because financial institutions in practice do not invoke their right to require notice of withdrawals (Pet. Br. 32). A legal right is not to be ignored simply because it is rarely invoked in practice. Moreover, as discussed in Section I(B), *infra,* Congress amended the BHC Act in 1966 specifically to overturn the Board's conclusion that a deposit is withdrawable "on demand" if "in practice" an institution does not invoke its legal right to require advance notice of withdrawal. *See also* S. Rep. No. 368, 96th Cong., 1st Sess. 7 (1979) (acknowledging that advance notice of NOW account withdrawals "may not be required in practice").[10]

The Board's present position is further belied by its consistent holdings, prior to its abrupt reversal in *Beehive,* that financial institutions that both offer NOW accounts and make commercial loans are not "banks" under the BHC Act, because NOW accounts are not "demand" deposits. In *First Financial*

[10] The Board does not contend that the right to require notice is invoked any more frequently with passbook savings accounts than with NOW accounts. If the right to require notice were to lose legal significance simply because the right is rarely invoked, traditional passbook savings accounts would be transformed, along with NOW accounts, into "deposits that a depositor has *a legal right* to withdraw on demand"—a result that the Board concedes would be contrary to the BHC Act.

Like NOW accounts, traditional passbook savings accounts are not deposits that customers have a "legal right to withdraw on demand," because financial institutions may require advance notice before permitting a savings account customer to withdraw his funds. Accordingly, the statutory ban on paying interest on demand deposits does not apply to savings accounts, even though in practice a savings account customer may withdraw his money on demand.

Group of New Hampshire, 66 Fed. Res. Bull. 594 (1980), the Board approved a bank holding company's application under Section 4(c)(8) of the Act to acquire a guaranty savings bank that would offer NOW accounts and invest in commercial mortgages. Concluded the Board: "Guaranty savings banks . . . are not banks within the meaning of the [BHC] Act since they *do not accept demand deposits* and engage in the business of making commercial loans." 66 Fed. Res. Bull. at 596 (emphasis supplied). Additionally, the applications approved in two cases involving Heritage Banks, Inc., revealed that the guaranty savings banks to be operated already accepted NOW accounts; yet in each case the Board's order approving the application also authorized the guaranty savings bank to make commercial loans. *Heritage Banks, Inc.,* 66 Fed. Res. Bull. 590 & 917 (1980). *See also Profile Bankshares, Inc.,* 61 Fed. Res. Bull. 901 (1975).

The "legal right" phraseology of Section 2(c) does not appear in any other definitional provision of the federal banking statutes. It cannot be assumed, as the Board would have it, that the precise terminology employed by Congress in the BHC Act is merely a legislative shorthand for "checking account," or "account accessible by check," or the like. Wherever else Congress has wished to base legislation upon the "checkable" nature of transaction accounts, it has done so in explicit language. For example, in 1968 Congress amended the Home Owners' Loan Act to clarify the authority of federally chartered savings and loan associations to accept savings accounts. The legislation expressly provided that such savings accounts "shall *not* be *subject to check.*" Pub. L. No. 90-448, § 1716(a), 82 Stat. 608 (codified at 12 U.S.C. § 1464(b)) (emphasis supplied).[11]

Thus, far from "incorporat[ing] prior statutory language in [the] new statute," and thereby presumably "incorpo-

[11] Similarly, the remedial legislation reported by the House Banking Committee on June 18, 1985 would define a bank under Section 2(c) of the BHC Act as any institution that, among other things, "accepts demand deposits or deposits that the depositor may withdraw by check or similar means for payment to third parties . . . ." H.R. 20, 99th Cong., 1st Sess. § 2(a) (1985).

rat[ing] long-standing administrative interpretations of earlier statutory language" (Pet. App. 37a n.20), Congress departed from earlier statutory usage with the "legal right" language in Section 2(c). It thereby signaled that extant administrative interpretations of other federal banking statutes would not govern under the BHC Act.

B. The Board's Revised Definition Defies the Legislative History of the 1966 Amendments to the BHC Act

1. Congress Amended the BHC Act in Order To Overturn the Board's Ruling that the Act Encompassed Institutions Offering Accounts that "In Practice" Are Payable on Demand

The origin of the definition of "bank" in Section 2(c) of the BHC Act confirms that when Congress used the phrase "legal right to withdraw on demand," it meant exactly what it said.

As originally enacted in 1956, the BHC Act defined "bank" as "any national banking association, or any State bank, savings bank, or trust company." Act of May 9, 1956, ch. 240 § 2(c), 70 Stat. 133. Under that definition, the Board issued two controversial rulings in which it applied the Act to industrial banks, like many of the respondents herein. In "Applicability of the Bank Holding Company Act to Industrial Banks," 49 Fed. Res. Bull. 165 (1963), the Board acknowledged that the Act "was directed principally at control of 'commercial' banks," and that " 'industrial banks' . . . were not regarded as being engaged in commercial banking." *Id.* at 166. Nonetheless, the Board ruled, the acquisition of an industrial bank would be subject to the Act if the industrial bank "accepts deposits subject to check or otherwise accepts funds from the public that are, *in actual practice, repaid on demand,* as are demand or savings deposits held by commercial banks." *Id.* (emphasis supplied). Two years later, the Board restated its position in "Industrial Banks as 'Banks' under Bank Holding Company Act," 51 Fed. Res. Bull. 1539-40 (1965). There the Board ruled that the Act applied to industrial banks issuing investment certificates that were "repaid, *in practice,* on demand." *Id.* at 1540 (emphasis supplied).

Significantly, in light of the Board's present position (Pet. Br. 28), the Board said nothing in the second proceeding about the acceptance of deposits "subject to check." Rather, in both cases, the Board's decision turned on the fact of payment on demand "in actual practice," without regard to the nature of the instrument of withdrawal.

During hearings on proposed amendments to the BHC Act in 1966, witnesses called upon Congress to overturn the Board's application of the statute to industrial banks. *Hearings on S. 2353, S. 2418, and H.R. 7371 Before a Subcomm. of the Senate Comm. on Banking & Currency,* 89th Cong., 2d Sess. 155-57, 394-95 (the "1966 Senate Hearings"). In response to the testimony, Senator Robertson, Chairman of the Banking and Currency Committee, called on the Board to comment on a proposed amendment that would have excluded industrial banks from the definition of "bank" under the Act. The Board responded:

> "The Board believes that the definition should be amended to cover only 'an institution that receives deposits payable on demand,' thereby limiting coverage to commercial banks (*i.e.,* banks that offer checking accounts), and *excluding not only industrial banks but other savings banks that accept funds from the public that are paid on demand.*
>
> "The Board has interpreted the present act as covering industrial banks that accept 'funds from the public that are, *in actual practice, repaid on demand.*' We believe this is the correct legal interpretation of the present statute, *but we see no reason in policy to cover such institutions under this act* . . . .
>
> "Accordingly, we suggest that S. 2353 be amended by striking lines 6 through 14 on page 3 and inserting in lieu thereof the following:
>
> " '(c) "Bank" means any institution that accepts deposits payable on demand' . . . ." 1966 Senate Hearings, *supra,* at 447 (1966) (April 20, 1966 letter of Board of governors) (emphasis supplied).

Thus, the Board recognized a distinction between (i) deposits that "in practice" are paid on demand and (ii) deposits that are truly "payable on demand." The Board accepted that its past decisions, treating as "banks" any institutions that in practice repaid on demand, were inappropriate as a matter of statutory policy (if not of statutory construction). Further, the Board urged, the BHC Act should be rewritten to define a "bank" as an institution that "accepts deposits payable on demand," thereby excluding any financial institution that required notice before repaying deposits, even if *in practice* the institution permitted withdrawals of such deposits on demand. Significantly, the Board nowhere suggested that the test for "demand" deposits in its proposed legislation should turn on whether the depositor made his demand for repayment by "check" or other negotiable instrument, as opposed to presentation of his passbook or other documentation at the teller's window.

Congress accepted the Board's confession of error, but to guard against administrative relapse, went one step further than the Board had recommended. Far from enacting the Board's proposal "in substance" (Pet. Br. 29), Congress rejected it. Instead, Congress set out to ensure that an industrial bank that in practice repays deposits "on demand" without legal compulsion to do so is not a "bank" covered by the BHC Act. Congress limited the definition of "bank" to "any institution that accepts deposits that the depositor has *a legal right* to withdraw on demand. . . ." Act of July 1, 1966, Pub. L. No. 89-485, 80 Stat. 235 (emphasis supplied). Congress thereby expanded on the Board's concession and overrode the Board's two prior rulings on the subject.

In other words, Congress used the words "legal right to withdraw on demand" in the amended Section 2(c) to exclude institutions that reserve the right to require notice before allowing their customers to withdraw funds, even if *in practice* the institutions permit withdrawals on demand. In so doing, Congress foreclosed the Board from arguing, as it does now, that vague notions of "transactional capability" somehow could transform a nondemand account into an account covered by Section 2(c) of the BHC Act.

2. Congress Intended the BHC Act To Apply Only to Commercial Banks, and Not to Industrial Banks

Congress also made clear in 1966 that the primary intended beneficiaries of the new statutory language in Section 2(c) were to be industrial banks, like respondents herein. The Senate Report accompanying the 1966 amendments to the BHC Act explained that the objective was to ensure that the Act would not cover industrial banks:

> "The purpose of the act was to restrain undue concentration of control of commercial bank credit, and to prevent abuse by a holding company of its control over this type of credit for the benefit of its nonbanking subsidiaries. *This objective can be achieved without applying the act to savings banks,* and there are at least a few instances in which the reference to 'savings bank' in the present definition *may result in covering companies that control two or more industrial banks. To avoid this result,* the bill redefines 'bank' as an institution that accepts deposits payable on demand (checking accounts), the commonly accepted test of whether an institution is a commercial bank *so as to exclude institutions like industrial banks* and nondeposit trust companies." S. Rep. No. 1179, 89th Cong., 2d Sess. 7 (1966) (emphasis supplied).

When the bill came to the Senate floor less than a month later, Chairman Robertson made clear that it was not the Committee's intention to convert industrial banks and similarly situated thrift institutions into "banks" on the theory that savings accounts would be magically transformed into deposits payable on demand as a "legal right" simply by use of a "check-like" instrument as a means of access. Said the Chairman:

> "The committee amended the definition of the term 'bank' so that it now covers 'any institution that accepts deposits that the depositor has a legal right to

withdraw on demand.' *This definition clearly excludes industrial banks,* mutual savings banks, and trust companies such as the Hershey Trust Co., which accepts no deposits whatever. *Since these institutions do not receive deposits in the form ordinarily received by commercial banks,* it was considered appropriate to change the definition of banks so they would not be covered by the act, and the committee report makes it clear that this exclusion is based on the fact that, if an institution does not accept demand deposits, it cannot be considered a commercial bank subject to the provisions of the act." 112 Cong. Rec. 12386 (June 6, 1966) (emphasis supplied).

The Board concedes that the 1966 amendments "were designed to exclude from coverage under the Act . . . industrial banks" (Pet. App. 24a; *see also id.* at 42a). Nonetheless, without any intervening legislative change, the Board now has revised Regulation Y in order to expand the coverage of the Act so that it will again include industrial banks.

In the *Beehive* case, the court of appeals properly concluded that the legislative history of the BHC Act compelled rejection of the Board's approach. Said the court:

> "Congress . . . overturned the Board's interpretation by substituting the '*legal right* to withdraw' language for the Board's right to withdraw on demand *in actual practice* provision. That differentiation, in the words of the Senate Banking Committee chairman, 'clearly excludes industrial banks.' No room exists for an argument that a practice as to NOW accounts should prevail rather than the statute." 728 F.2d at 437 (citation omitted) (emphasis in original).

3. The Legislative History Shows that Congress Did Not Define "Bank" in Terms of the Instrument by Which Deposits May Be Withdrawn

The Board now contends that the legislative history of the 1966 amendment somehow supports its revised Regulation Y, on the theory that Congress supposedly considered the use of

check-like instruments of withdrawal to be the litmus test for "banks" under the Act (*see, e.g.,* Pet. 11; Pet. Br. 30). That contention is unsupported by the legislative record. There is no evidence that Congress ever focused on instruments of withdrawal when it redefined the term "bank" to exclude institutions where customers "in practice," but not in law, could withdraw funds on demand. The Congressional objective in amending Section 2(c) in 1966 was not to establish the "check" or "check-like instrument" as the talisman for determining whether an institution is a "bank." Rather, Congress repudiated the Board's earlier decisions that the Act encompassed industrial banks that "in practice" allowed customers to withdraw deposits on demand—decisions that did not turn on the type of instrument used to effect withdrawals, and that swept in passbook and other window withdrawals as well as "checkable" accounts.[12]

Thus, Congress established that an institution reserving the right to require notice before paying *any* instrument of withdrawal—be it check, draft, withdrawal slip, or passbook—could not be deemed a "bank" under the Act. If Congress had intended to base the statutory test in Section 2(c) upon the instrument of withdrawal, rather than on the customer's *legal right* to withdraw on demand, it could have defined "bank" in terms of deposits from which withdrawals may be made by negotiable instrument, as the Board now attempts to do by administrative fiat. Congress did not do so.[13]

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[12] Before Congress, the Board conceded that the 1966 BHC Act amendment would "exclud[e] not only industrial banks but other savings banks that accept funds from the public that are [in practice] paid on demand." 1966 Senate Hearings, *supra,* at 447. At no time during the Congressional hearings in 1966 did the Board suggest that the BHC Act, as amended, would continue to include such institutions if they allowed withdrawals from nondemand accounts by "check-like" instruments.

[13] Certain portions of the legislative history now relied on by the Board suggest that some legislators used the "legal right" and "checking" account phraseology interchangeably. However, read in context, the term "checking" account was used simply as an example of an account fitting the statutory language, not as a substitute for the statutory language.

(footnote continues)

Moreover, the Board's contention that NOW accounts should be viewed as "functionally equivalent" to checking accounts for purposes of the BHC Act ignores important differences between the two categories of deposits—differences that bear directly on the Congressional policies underlying the 1966 amendment to Section 2(c). In that Section, Congress set out to limit the regulatory sweep of the Act even as it expanded the scope of the statute elsewhere. Congress wanted to control the relations among business firms and commercial banks; it did not wish to cast its regulatory net over all financial institutions. That Congressional objective would be thwarted if NOW accounts were viewed as equivalent to checking accounts in the Act's definition of "bank." Traditional checking accounts, which typically cannot be offered by industrial loan companies, constitute one of the most significant relationships between businesses and commercial banks. Such accounts serve as repositories for liquid funds maintained by businesses; they provide interest-free commercial funds for use by banks; they provide businesses with the means of engaging in day-to-day commercial transactions. By contrast, NOW accounts may be maintained only by natural persons and certain nonprofit organizations; commercial businesses may not use them. *See, e.g.*, 12 U.S.C. § 1832(a); Utah D.F.I. Reg. No. 2(BR 162).

Congress' progressive *narrowing* of the "bank" definition is entirely consistent with its simultaneous *expansion* of the substantive restraints fashioned by the amended BHC Act on

(footnote continued)

The fact that NOW accounts did not exist as such when Congress amended the BHC Act in 1966 does not mean, as the Board argues, that Congress necessarily intended the term "legal right to withdraw on demand" to encompass all accounts subject to check (Pet. Br. 14, 28). In fact, some State financial institutions were offering savings accounts accessible by check in 1966. In Maryland, for example, mutual savings banks had "permitted withdrawals by check since 1869"; yet, because these checkable accounts were subject to a "30 day notice of withdrawal limitation," the accounts were not considered demand deposits. *Savings Bank* v. *Bank Commissioner*, 248 Md. 461, 237 A.2d 45, 52-53 (1968). Thus, when Congress amended the BHC Act in 1966, it cannot be presumed to have intended that all accounts accessible by check would be encompassed by the "legal right" language.

entities deemed "banks" and "bank holding companies" within the reach of the statute. Because of the numerous restrictions imposed by the Act on "bank holding companies"—most notably, the prohibition against engaging in nonbanking activities, except in defined circumstances—Congress confined the definition of affected institutions, so as to ensure that only those entities whose coverage truly was required to effectuate the purposes of the statute would be swept within its coverage.

II. THE BOARD'S ACTION CANNOT BE JUSTIFIED UNDER ITS STATUTORY POWER TO PREVENT "EVASIONS" OF THE ACT

Even though the Board's expanded definition of the term "bank" contravenes the plain language of the BHC Act as well as the Congressional intention underlying that language, the Board seeks to justify its new definition by reference to Section 5(b) of the BHC Act, 12 U.S.C. § 1844(b). That Section authorizes the Board "to issue such regulations and orders as may be necessary to enable it to administer and carry out the purposes of this chapter and prevent evasions thereof." According to the Board, industrial banks and other thrift institutions somehow are "evading" the BHC Act by offering NOW accounts rather than traditional checking accounts. Under the Board's theory, the general enforcement authority under Section 5(b) empowers the Board to ignore the statutory language in order to prevent such industrial banks from "evading" the regulatory scope of the Act.

The vast majority of financial institutions adversely affected by the Board's expanded definition of "bank" were not created to take advantage of any "loophole" in the Act. On the contrary, most affected institutions are longstanding industrial banks or similar State-chartered thrift institutions, never previously considered "banks," that began to offer NOW accounts —in accordance with State law—at a time that the Board did not regard NOW accounts as "demand" deposits under the Act. Most of the institutions offering NOW accounts that are affected by the Board's revised Regulation Y have never offered demand checking accounts. It is bizarre for the Board to

suggest that such institutions now are "evading" the Act, simply because they decided, in many cases years ago, to offer NOW accounts in full compliance with applicable law, both State and federal.

More importantly, it is disingenuous for the Board to contend that it may creatively interpret the statutory language under its general power to prevent "evasions" of the statute when the result is to defy Congressional intent and to sweep within the Act's coverage institutions that Congress deliberately *excluded* from the coverage of the Act. As this Court said in *Ernst & Ernst* v. *Hochfelder,* 425 U.S. 185, 213-14 (1976):

> "The rulemaking power granted to an administrative agency charged with the administration of a federal statute is not the power to make law. Rather, it is 'the power to adopt regulations to carry into effect *the will of Congress as expressed by the statute*'" (citations omitted) (emphasis supplied).

Under the guise of revising Regulation Y, the Board is attempting again to accomplish what Congress forbade it to do in 1966. The Board contends that to prevent "evasions" of the BHC Act, it must regulate industrial banks offering NOW accounts, because NOW accounts are "in practice" payable on demand. Yet Congress rewrote Section 2(c) in 1966 precisely in order to preclude the Board from regulating industrial banks that offered accounts "in practice" payable on demand. *See* Section I(B), *supra.*

Nor can the Board find justification for its revision of Regulation Y in the court of appeals' decision in *Wilshire Oil Co.* v. *Board of Governors,* 668 F.2d 732 (3d Cir. 1981), *cert. denied,* 457 U.S. 1132 (1982). There an existing bank holding company that owned a commercial bank (Trust Company of New Jersey) caused its bank subsidiary to advise its customers holding noninterest-bearing demand deposits (*i.e.,* traditional checking accounts) that henceforth it would reserve the right to require prior notice of withdrawal, but that it had "no intention of exercising" that right. 668 F.2d at 733-34. By this transparent device, the commercial bank sought to convert its

conventional checking accounts into something other than "demand" deposits, so as to remove itself from the coverage of the BHC Act. The sole purpose of the commercial bank's sham notice requirement was to evade regulation by the Board.

The Court of Appeals for the Third Circuit noted the differences between the commercial bank's checking accounts and NOW accounts. 668 F.2d at 736-37. The court ruled that the commercial bank's sham reservation of a right to require notice of withdrawal on the checking accounts had no effect on its status as a "bank" under the BHC Act. Nowhere did the court suggest that financial institutions such as industrial banks could be brought within the scope of the BHC Act by equating NOW accounts with demand deposits, or that regulation of such institutions was necessary to prevent "evasions" of the BHC Act.[14]

In revising Regulation Y, the Board itself is evading the Act. It is striving to override both the letter and spirit of Section 2(c) by ignoring the statutory purpose behind the 1966 amendment of that Section, and by rewriting the Section to suit its own concept of appropriate banking policy. Congress has determined that the BHC Act should not encompass industrial banks. Congress also has determined that the statutory definition of "bank" should not be triggered by institutions offering

[14] The Board similarly acknowledged the differences between the checking accounts at issue in *Wilshire* and NOW accounts:

> "The reservation of the right to prior notice has resulted in no change whatsoever in the operation of [Trust Company's] . . . demand deposits. The deposits remain *non-interest bearing,* are in fact payable on demand, and are withdrawable by *business depositors* by negotiable order." *In re Wilshire Oil Co.,* No. 1114026, slip op. at 18 (April 2, 1981) (emphasis supplied).

In commenting upon the *Wilshire Oil* precedent, the court of appeals correctly said in *Beehive:*

> "The *Wilshire* court 'penetrat[ed] the form of the contracts to the underlying substance of the transaction.' 668 F.2d at 740. No such piercing is possible here as the NOW accounts differ legally as well as in form from demand deposits. The substantive differences include that NOW accounts bear interest, are unavailable to certain depositors, and cannot be subject to a legal right of withdrawal on demand under Utah law." 728 F.2d at 436.

accounts that "in practice," but not in law, are subject to withdrawals on demand. Under these circumstances, the Board is not free to override Congressional language and intent under the guise of preventing "evasions" of the administrative agency's notions of proper statutory objectives.

Even if a revision of Section 2(c) were necessary to deal with changes in the banking industry, it would be the province of Congress, not the Board, to make such statutory changes. Section 5(b) does not transfer legislative authority from Congress to the Board.

III. THE BOARD'S REDEFINITION OF "DEMAND" DEPOSITS IS IN CONFLICT WITH THE FEDERAL STATUTORY POLICIES THAT SANCTION NOW ACCOUNTS AND WITH THE BOARD'S OWN REGULATIONS

A. Federal Statutes Rely on the Reservation of the Right To Require Notice in Order To Distinguish NOW Accounts from Demand Deposits

NOW accounts have been in existence since 1972, when the Supreme Judicial Court of Massachusetts held that State savings banks could permit their customers to withdraw deposits from savings accounts by negotiable order as well as by presentation of a passbook. *Consumer Savings Bank v. Commissioner of Banks,* 282 N.E.2d 416 (Mass. 1972).

Congress initially responded by confining the availability of NOW accounts to Massachusetts and New Hampshire. Act of Aug. 16, 1973, Pub. L. No. 93-100, § 2, 87 Stat. 342. At the same time, Congress authorized federally chartered financial institutions in those States to offer the accounts. *Id.* Congress subsequently extended the NOW "experiment" to the rest of New England,[15] New York,[16] and New Jersey,[17] before permitting NOW accounts nationwide beginning Dec. 31, 1980. Depository Institutions Deregulation and Monetary Control Act

[15] Act of Feb. 27, 1976, Pub. L. No. 94-222, § 2, 90 Stat. 197.

[16] Act of Nov. 10, 1978, Pub. L. No. 95-630, § 1301, 92 Stat. 3641, 3712.

[17] Act of Dec. 28, 1979, Pub. L. No. 96-161, § 106, 93 Stat. 1233, 1235.

of 1980, Pub. L. No. 96-221 (the "Monetary Control Act"), § 303, 94 Stat. 132, 146 (codified, as amended, at 12 U.S.C. § 1832 (1982)).

Congress consistently has recognized the distinction between NOW accounts and demand deposits based on the reserved right to require notice of withdrawal, and has relied upon that distinction in authorizing NOW accounts for depository institutions. The original version of enabling legislation in 1979 would have repealed outright the statutory prohibition on the payment of interest on demand deposits, and would have permitted federally insured thrift institutions to accept demand deposits. Instead, Congress opted for the narrower course of authorizing depository institutions to offer NOW accounts.[18] Congress did not permit interest to be paid on demand deposits, nor did it empower thrifts to accept demand deposits. In so doing, it recognized NOW accounts as a specialized interest-paying savings account, subject to the right to require notice of withdrawal. Said the Senate report accompanying the proposed legislation:

> "Under the definition of a NOW account, a depository institution *may* require a depositor to give 30 days notice before a withdrawal from a NOW account is made, similar to the notice requirement on any savings account, *although such notice may not be required in practice.*" S. Rep. No. 368, 96th Cong., 1st Sess. 7 (1979) (emphasis supplied).

Congress further distinguished NOW accounts from demand deposits by making NOW accounts available only to individuals and certain nonprofit institutions.[19] By contrast, demand accounts not subject to any notice provision generally

[18] Monetary Control Act, § 303, 94 Stat. 132, 146 (codified at 12 U.S.C. § 1832 (1982)).

[19] Monetary Control Act, § 303, 94 Stat. 132, 146 (codified at 12 U.S.C. § 1832 (1982)). NOW accounts are limited to accounts "in which the entire beneficial interest is held by one or more individuals or by an organization which is operated primarily for religious, philanthropic, charitable, educational, or other similar purposes . . . and with respect to deposits of public funds. . . ." 12 U.S.C. § 1832(a) (1982), as amended by the Garn-St Germain Depository Institutions Act of 1982, Pub. L. No. 97-320, § 706, 96 Stat. 1469, 1540.

are available through commercial banks to any person, including corporations.

When Congress elected to permit NOW accounts, rather than allow the payment of interest on demand deposits, it did so with full awareness that the reserved right to require notice of withdrawal that distinguishes NOW accounts from demand deposits likely would not be exercised. *See Hearings on H.R. 3864 Before the Subcomm. on Financial Institutions, Supervision, Regulation and Insurance of the House Comm. on Banking, Finance and Urban Affairs,* 96th Cong., 1st Sess. 103-04 (1979) (testimony of Charles Partee, Member, Bd. of Governors, Federal Reserve System); *id.* at 153 (statement by Congressman Wylie that the notice requirement "has never been used").

The distinction between checking accounts and NOW accounts also is found in the Federal Deposit Insurance Act.[20] The policy was reaffirmed in 1982, when Congress extended limited demand account powers to thrift institutions that previously had been able to offer only NOW accounts and other savings accounts.[21] There, Congress distinguished the newly authorized demand accounts from the institutions' existing savings accounts, including those subject to negotiable orders of withdrawal, by directing that the latter accounts "be subject to the right of the association to require [at least fourteen days] advance notice" of intended withdrawal.[22]

When Congress has wanted to permit the Federal Reserve Board to treat NOW accounts in the same manner as demand checking accounts, it has done so expressly. The act authorizing NOW accounts nationwide also authorized the Board to set

[20] Insured savings banks, required to hold only time deposits or deposits subject to the right to require notice of withdrawal, 12 U.S.C. § 1813(g) (1982), may offer NOW accounts subject to the notice requirement, *see* 12 C.F.R. § 329.5(c)(4), but not "checking" accounts, *see* 12 U.S.C. § 1813(g) (1982).

[21] Garn-St Germain Depository Institutions Act of 1982, Pub. L. No. 97-320, § 312, 96 Stat. 1469, 1496-97 (codified at 12 U.S.C. § 1464(b) (1982)).

[22] *Id.* § 312(1)(C) (codified at 12 U.S.C. § 1464(b)(1)(C) (1982)).

reserve requirements for NOW accounts as well as for demand deposits.[23] There was no suggestion that, absent such express authority from Congress, the Board would have been able to impose reserve requirements on nonmember depository institutions simply because they offered NOW accounts.

B. The Board's Regulations Treat NOW Accounts as Savings Deposits, Not Demand Deposits

For decades, the Board's own regulations have relied upon the notice reservation as the key legal characteristic of savings accounts that causes them not to violate the federal statutory ban on the payment of interest on demand deposits. Since the inception of federal interest rate controls in 1933, the governing law has prohibited the payment of interest on demand deposits. 12 U.S.C. § 371a. If NOW accounts (or other interest-bearing accounts accessible by draft or check) were demand deposits, their offering would violate that statute. However, interest is payable on NOW accounts, *see* 12 U.S.C. § 1832(a), inasmuch as NOW accounts are subject to a reserved right of notice. 12 C.F.R. §§ 217.1(e) & 329.1(e)(2). *Accord,* 12 U.S.C. § 1464(b) (federal savings and loan associations); 12 C.F.R. § 329.2(a) (FDIC prohibition on payment of interest on demand deposits by insured nonmember banks); *see* S. Rep. No. 368, *supra,* at 8; *see also* A. Kaplan, *Federal Legislative and Regulatory Treatment of NOW Accounts,* 91 Banking L.J. 439, 443-44 (1974).

In two of the most important regulatory schemes promulgated and administered by the Board—its Regulations D and Q, which impose, respectively, reserve requirements and interest-rate limitations on deposits in depository institutions, 12 C.F.R. §§ 204, 217—the Board long has distinguished interest-bearing savings accounts from demand deposits by requiring that the former be subject to the reservation of the right of notice of withdrawal, and that such accounts not be offered to commercial customers.

[23] Monetary Control Act, § 103, 94 Stat. 132, 133-38 (codified as amended, in scattered sections of 12 U.S.C.) (empowering Board to impose reserve requirements on "transaction accounts," defined to include both demand deposits and NOW accounts).

In recent years, the Board has amended Regulations D and Q to make provision for NOW accounts. In both regulatory schemes, the Board has declined to classify such accounts as "demand deposits." Regulation D defines a "demand deposit" as

> "a deposit that is payable on demand, or a deposit issued with an original maturity or required notice period of less than seven days, or a deposit representing funds *for which the depository institution does not reserve the right to require at least seven days' written notice of an intended withdrawal.*" 12 C.F.R. § 204.2(b)(1) (emphasis supplied).

Regulation D continues: "The term ['demand deposit'] includes all deposits other than time and savings deposits." *Id.* The Regulation then defines a "savings deposit" as a deposit or account

> "with respect to which the depositor is not required by the deposit contract *but may at any time be required by the depository institution to give written notice of an intended withdrawal not less than seven days before withdrawal is made* . . . ." 12 C.F.R. § 204.2(d)(1) (emphasis supplied).

Regulation Q likewise distinguishes between "demand deposits" and "savings deposits." Section 217.1(e)(2) of Regulation Q defines "savings deposit" in the manner of Regulation D, above, and then classifies NOW accounts as "savings deposits":

> "Deposits subject to negotiable orders of withdrawal may be maintained if such deposits consist of funds in which the entire beneficial interest is held by (A) one or more individuals; (B) a corporation, association, or other organization operated primarily for religious, philanthropic, charitable, educational, fraternal, or other similar purposes and not operated for profit; or (C) the United States, any State of the United States, . . . or any political subdivision thereof." *Id.* § 217.1(e)(3).

In 1973, when Congress first authorized NOW accounts, the Board amended Regulation Q to permit depository institutions in Massachusetts and New Hampshire to offer NOW accounts along with their State-chartered or -insured counterparts. In its public notice of the proposed amendment, the Board explained:

> "The Board proposes to treat the NOW account *as a form of savings deposit.* This would mean that (1) such accounts may be offered only to individuals and certain nonprofit organizations, and (2) withdrawals from such accounts are *subject to the right of the bank to require the depositor to give at least 30 days' notice of any intended withdrawal, although this right need not be exercised.*" 38 Fed. Reg. 26,468 (1973) (emphasis supplied).

Thus, the Board recognized that NOW accounts were to be treated as savings deposits, not demand deposits. Additionally, the Board acknowledged that "the amendment *treats deposits on which NOW's may be drawn as savings deposits* and thereby limits the use of NOW's to individuals and certain non-profit organizations." 38 Fed. Reg. 34,457 (1973) (emphasis supplied). Further, the Board expressly exempted NOW accounts from the provision in Regulation Q that forbids withdrawal of deposits from savings accounts by means of check or other negotiable instrument. *Id.* (promulgating new 12 C.F.R. § 217.5(c)(3)).[24]

In sum, the Board's Regulations D and Q show that NOW accounts do *not* constitute demand deposits because the offering institution reserves the right to require notice prior to

[24] In authorizing nonmember thrift institutions to make use of the Federal Reserve System's draft collection procedures, the Board at one point considered the imposition of a "clearing account" requirement with the Federal Reserve Bank of Boston that would have equalled 3% of the total NOW account deposits in participating institutions. 38 Fed. Reg. 26,469 (1973). The 3% limit equalled the reserve requirement for member banks' *savings* deposits. *See* A. Kaplan, *supra* p. 31, at 450.

withdrawal—without regard to whether the right in fact is invoked.[25]

In still other pronouncements, the Board has made it plain that a financial institution's right to require prior notice is the fundamental distinction between a savings deposit and a deposit that legally may be withdrawn "on demand." As the Board has said in federal court:

> "The critical distinction between demand deposits and savings deposits *has always been that the depositor does not have the legal right to withdraw funds from a savings deposit on demand* and that the bank has a legal right to demand 30 days' notice of withdrawal of such funds." Brief for Appellees at 28, *United States League of Savings Ass'ns* v. *Board of Governors of the Federal Reserve System,* 686 F.2d 953 (D.C. Cir. 1979) (emphasis supplied).

In April 1985, well after the decision of the court of appeals below, Chairman Volcker, in urging the adoption of remedial legislation, told the Congress that "institutions with a bank charter can . . . take all kinds of deposits from the public (including under current court rulings NOW accounts) *other than demand deposits* and make commercial loans without coming under the restrictions of the Bank Holding Company Act." Prepared Statement of Paul A. Volcker, Chairman, Board of Governors, Before the Subcommittee on Financial Institutions, Supervision, and Regulation of the House Committee on Banking, Finance and Urban Affairs, April 17, 1985, at 5

[25] The FDIC also has acknowledged that NOW accounts are offered as a form of savings deposit, subject to the same restrictions and limitations as other savings deposits. *See* 38 Fed. Reg. 34,458 (1973). In its regulations regarding interest on deposits, the FDIC defines savings deposits to include "all interest bearing deposits subject to withdrawal by negotiable or transferrable instruments for the purpose of making transfers to third parties where such withdrawals are authorized by law." 12 C.F.R. § 329.1(e)(2) (1983). "Demand deposits," on the other hand, are defined as all deposits that are not "time deposit[s]" or "savings deposit[s]." 12 C.F.R. § 329.1(a). The Federal Home Loan Bank Board, in its regulations governing the payment of interest, defines a NOW account as "a *savings account* authorized by 12 U.S.C. § 1832 on which interest is paid. . . ." 12 C.F.R. § 526.1(l) (1983) (emphasis supplied).

(emphasis supplied). Thus, Chairman Volcker reiterated the common understanding that NOW accounts are not classified as demand deposits.[26]

IV. THE BOARD'S ACTION CONSTITUTES AN UNLAWFUL EXPANSION OF ITS STATUTORY AUTHORITY

A. Congress Has Manifested Its Intention that It, Rather than the Board, Should Control the "Bank" Definition

In using the term "demand" deposit in the BHC Act, Congress did not use ambiguous words or leave an extensive area of law to be developed by the Board. *Cf. Patagonia Corp.* v. *Board of Governors,* 517 F.2d 803, 813 n.11 (9th Cir. 1975). Rather, the first prong of the "bank" definition is written in precise language. Moreover, the terminology represents a fundamental Congressional limit on the Board's jurisdiction. The Board acknowledges that the bank definition "is the key to the Act" (Pet. App. 20a).

The proper interpretation of the statutory definition of "bank" is not committed to the Board's "expertise." In enacting the "bank" definition in Section 2(c), and subsequently in narrowing the definition by a series of amendments over the years, Congress has not conferred authority on the Board to expand that definition by administrative fiat. The "demand" deposit prong of the "bank" definition does not leave it open to the Board to employ its "expertise" in deciding what institutions should be "banks" under the Act. The Board is not empowered to "interpret" the "legal right" test for demand

[26] Finally, it is noteworthy that the Board's staff, in assessing the impact of NOW accounts, carefully distinguished NOW accounts from "demand deposits" while classifying both of them in the category of "[o]ther checkable deposits." *See* Simpson & Williams, *Recent Revisions in the Money Stock,* 67 Fed. Res. Bull. 539 & n.1, 541, 542 (1981) ("[o]ther checkable deposits consist of *NOW*... and ATS (Automatic Transfer Service) *accounts* at commercial banks and thrift institutions, credit union share draft accounts, and *demand deposit accounts* at thrift institutions") (emphasis supplied).

deposits in Section 2(c) in a way that effectively reads it out of the statute.[27]

Each time Congress has amended the definition of "bank" in Section 2(c) of the BHC Act, it has *narrowed* the definition. The BHC Act originally defined a bank as "any national banking association or any State bank, savings bank, or trust company." 70 Stat. 133. In 1966, Congress amended the definition to exclude industrial banks and similar thrift institutions. In 1970, Congress again narrowed the definition, this time by imposing the additional requirement that an institution must be "engage[d] in the business of making commercial loans." And in 1982, as part of the Garn-St Germain Depository Institutions Act, Congress again narrowed the statutory definition, this time by exempting federally insured State-chartered savings and loan associations. Pub. L. No. 97-320, § 333, 96 Stat. 1504.[28]

Congress' allocation of definitional authority under the BHC Act differs altogether from that found in, say, the Federal

[27] *See, e.g., Patagonia Corp.* v. *Board of Governors, supra,* 517 F.2d at 813 n.11 ("Congress did not write the Act in general terms, thus leaving extensive areas of law to be developed by the Board"); *Western Bancshares, Inc.* v. *Board of Governors,* 480 F.2d 749, 752-54 (10th Cir. 1973) (Congress did not give Board a "broad grant" of power to act in the public interest); *see also American Bankers Association* v. *Connell,* 686 F.2d 953, 954 (D.C. Cir. 1979) (Board is not empowered to promulgate regulations that "rewrite the language of statutes which may be antiquated in dealing with the most recent technological advances").

[28] The 1982 amendment does not permit the inference that Congress intended State-insured thrift organizations to become subject to the BHC Act as "banks." The 1982 exemption for federally insured thrifts came about only because the Garn-St Germain Act simultaneously empowered federally insured thrifts, for the first time, to offer conventional demand deposit accounts, *id.,* § 312, 96 Stat. 1496, as well as to make commercial loans at a heightened level of activity, *id.,* § 325, 96 Stat. 1500. As noted above, federally chartered thrifts already were empowered to offer NOW accounts. Thus, the exemptive language added to Section 2(c) of the BHC Act in 1982 was necessitated by the introduction of statutory authority to federally insured thrifts to offer *conventional* checking accounts. *See* S. Rep. No. 536, 97th Cong., 2d Sess. 15 (1982).

Reserve Act, where since 1935 the Board has been expressly authorized

> "*to define the terms used in this section,* to determine what shall be deemed a payment of interest, *to determine what . . . shall be deemed a deposit,* and to prescribe such regulations as it may deem necessary to effectuate the purposes of this section [of the Reserve Act] and to prevent evasions thereof." 12 U.S.C. § 461(a) (emphasis supplied).[29]

In sum, this Court's analysis in *Securities Industry Ass'n* v. *Board of Governors,* ____U.S.____, 104 S. Ct. 2979, 2989 (1984) ("*Bankers Trust*"), applies with equal force here:

> "When Congress has concluded that a particular form of [institution] should be covered by the Act's prohibitions, it has amended the statute accordingly . . . . [W]e find it difficult to imagine that Congress intended the Board to engage in the subtle and ad hoc 'functional analysis' described by the Board." [30]

[29] This is the statutory authority for the Board's promulgation of its Regulation Q, prescribing applicable interest-rate limitations, discussed in Part III(B) of this Brief.

[30] The Board elsewhere has correctly stated the operative principle of statutory construction. In opposing the suggestion that it should disregard the "commercial loan" prong of the "bank" definition in Section 2(c) in order to implement the Congressional policy embodied in the Douglas Amendment, the Board has said:

> "In spite of the definition of 'bank' already provided in section 2(c) of the BHC Act, petitioners attempt to redefine 'bank' for purposes of the Douglas Amendment *and thus in effect read the 1970 Amendment of the bank definition in section 2(c) out of the Act.* It is well-settled, however, *that an agency cannot modify the clear language of a statute . . . . Nor may the Board interpret the Act in a manner which fails to give effect to the Act's definition of bank.* It is clearly established that a statute must be interpreted so as not to render one part inoperative, . . . and that all parts of a statute must be given effect if possible . . . ." Brief for Respondent Board of Governors of the Federal Reserve System at 22-23, *Florida Department of Banking and Finance* v. *Board of Governors,* 760 F.2d 1135 (11th Cir. 1985) (emphasis supplied) (citations deleted).

B. The Board's Policy Concerns Properly Should Be Addressed to Congress, Not the Courts

Faced with the inherent flaws in its legal argument that NOW accounts are encompassed by the statutory term "deposits that the depositor has a legal right to withdraw on demand," the Board seeks refuge in the argument that adherence to the statutory language somehow would do violence to the purposes of the BHC Act. The argument is devoid of support in the record, and cannot withstand close analysis.

According to the Board, the policies underlying the BHC Act "require a separation of banking and commerce" in order to avoid conflicts of interest, undue concentration of resources, and the transmission of unregulated financial risks to the banking system (Pet. Br. 10-11). In the Board's view, the "fundamental objectives of the BHC Act would be substantially undermined" if industrial banks and similar thrift institutions offering NOW accounts are not regulated as "banks" under the Act (*id.* at 12).

The Board's dire predictions may be disposed of summarily. Neither in the administrative proceeding nor in the subsequent review before the court of appeals did the Board advance any factual support for its purported concerns, nor did it point to a single instance in which any abuse has resulted from the fact that thrift institutions offering NOW accounts are not treated as "banks" under the BHC Act. Because the Board has failed to link any of its amorphous concerns to evidence in the record, those concerns should be accorded no weight. *See, e.g., Motor Vehicle Manufacturers Ass'n* v. *State Farm Mutual Automobile Insurance Co.*, 463 U.S. 29, 43 (1983); *U.S. Lines* v. *Federal Maritime Commission*, 584 F.2d 519, 534-35 (D.C. Cir. 1978).

Moreover, an examination of the purported threat posed by NOW accounts to the BHC Act reveals the insubstantiality of the Board's concerns. As the Board recognizes, the fundamental objective of the Act is to prevent abuses that might result if banking and commercial activities become intertwined. The BHC Act prevents such an outcome by subjecting to regulation any institution that *both* (i) accepts true demand deposits, generally available to commercial as well as

individual customers, and (ii) regularly uses such deposits to make loans to businesses. Unlike conventional checking accounts, NOW accounts may *not* be offered generally to business customers; they are available only to individuals and certain nonprofit organizations. Thus, NOW accounts do not provide the access to the commercial deposits that form the critical link in the allocation of bank credit to commercial enterprises.[31]

The Board's suggestion that as a matter of public policy its revision of the "bank" definition is an appropriate response to changes in the activities of industrial banks and other financial institutions, is of course properly addressed to Congress. "[T]his defect—if defect it is—is inherent in the statute as written, and its correction must lie with Congress." *Sedima, S.P.R.L.* v. *Imrex Company*, ____U.S.____, ____, 105 S.Ct. 3275, 3287 (1985).

Where developments in the financial services industry have warranted modifications to the statutory definition of "bank," Congress has made appropriate statutory changes in the past. Even now Congress has before it legislation that will address the "bank" definition in light of the Board's concerns. *See* H.R. 20, 99th Cong., 1st Sess. (reported favorably by House Banking Committee, June 18, 1985); S. 736, 99th Cong., 1st Sess. (1985).

The Board suggests that its "bank" definition is intended merely as a stop-gap measure to preserve the *status quo* pending Congressional action (*see, e.g.*, Pet. App. 22a). That argument is unavailing in at least two respects. *First*, as noted above, the Board's administrative action does not preserve the

[31] The Board also argues that an objective of the BHC Act is to restrict interstate acquisitions of banks. The argument is circular. As the Board has acknowledged, "the interstate banking prohibition in section 3(d) of the BHC Act pertains only to the interstate acquisition of banks and not to the acquisition of nonbank companies. . . ." Brief for Respondent Board of Governors at 17, *Florida Dept. of Banking & Finance* v. *Board of Governors, supra* n.30. In enacting the interstate banking restriction, Congress "expressed no concern . . . about the interstate acquisition of nonbanking firms." *Id.* at 18. Accordingly, no policy underlying the BHC Act is affected by allowing interstate acquisitions of financial institutions that do not meet the statutory definition of "bank."

pending situation, but, so far as industrial loan companies are concerned, entirely disrupts settled relations in the industry. *See* 744 F.2d at 1406 (Pet. App. 4a-5a).

Second, the Board's formal application to Congress for a statutory "moratorium" on the creation and acquisition of "non-bank banks" has failed of enactment. *See* S. 1532, 98th Cong., 1st Sess. (1983); H.R. 3499 & 3536, 98th Cong., 1st Sess. (1983). By itself, the Board's request for a legislative "freeze" amounts to a concession that under the present statute the Board lacks authority to address the subject. In any event, Congress' refusal to act upon the Board's request for interim legislative relief further undermines the Board's authority to act at its own behest. While not dispositive of legislative intent, Congress' refusal to codify—even as a temporary measure—the "bank" definition proffered by the Board is entitled to weight. *Cf. DeCanas* v. *Bica,* 424 U.S. 351, 360 n.9 (1976) ("Congress' failure to enact sanctions reinforces the inference that . . . Congress believes this problem does not yet require uniform national rules").

Here, several factors bolster the conclusion that Congressional inaction evinces an intent that industrial loan companies not be subject to the BHC Act. Specifically, as discussed above, Congress determined 19 years ago that industrial loan companies were not "banks." It tailored the statutory definition to give effect to that determination.

Moreover, through the Board and other sources, Congress has been kept fully apprised of the consequences supposedly flowing from the application of the present "bank" definition. *See, e.g., Moratorium Legislation and Financial Institutions Deregulation: Hearings Before the Senate Comm. on Banking, Housing and Urban Affairs on S. 1532, S. 1609 and S. 1682,* 98th Cong., 1st Sess. (1983). Over the course of the last several legislative sessions, Congress has studied the issue. It has heard the Board's arguments about the current trends in the financial services industry and the supposed need to alter the "bank" definition in order to preserve what the Board calls the "*status quo.*" Whether Congress has not acted because it approves of current trends, because it does not share the

Board's sense of urgency, or because it is seeking a more comprehensive reworking of the federal banking laws is beside the point here. What matters is that Congress has created a statutory definition, only Congress can change it, and, thus far, Congress has not done so.[32]

[32] A number of bills addressing the Act's "bank" definition were introduced in the 98th Congress. In addition to various moratoria proposed at the request of the Federal Reserve Board, *see supra* p. 40, more comprehensive bills introduced at the request of the Treasury Department, *see* 129 Cong. Rec. S. 9718 (daily ed. July 12, 1983) (statement of Sen. Garn introducing S. 1609) and of the FDIC, *see* 129 Cong. Rec. S. 10,890 (daily ed. July 26, 1983) (statement of Sen. Garn introducing S. 1682), also proposed reformulations of the "demand" deposit prong, together with various "grandfather" provisions for earlier acquired institutions. *See also* H.R. 3535, 98th Cong., 1st Sess. (1983); H.R. 3537, 98th Cong., 1st Sess. (1983).

None of the bills containing a revised "bank" definition was reported out by the House Committee on Banking, Finance and Urban Affairs. In the Senate, a bill modeled after the Treasury Department's proposed legislation, including the change in the "demand" deposit prong, subsequently was introduced. *See* 129 Cong. Rec. S. 17,031 (daily ed. Nov. 18, 1983) (statement of Sen. Garn introducing S. 2181). After mark-up by the Senate Committee on Banking, Housing and Urban Affairs, a new bill, S. 2851, which also contained revised "demand" deposit language, passed both the Committee and the Senate. *See* 130 Cong. Rec. S. 11,162 (daily ed. Sept. 13, 1984).

As noted, *supra* p. 39, the House Banking Committee at the current session of Congress has reported favorably a bill to amend the "bank" definition. H.R. 20, 99th Cong., 1st Sess.

CONCLUSION

For the foregoing reasons, respondents American Financial Services Association, *et al.* respectfully submit that the judgment of the court of appeals should be affirmed.

Respectfully submitted,

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September 11, 1985

APPENDIX A


No.
31-7156/3240
19
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Pay to the order of
Dollars
FOOTHILL THRIFT
1304 Foothill Drive Salt Lake City, Utah 84108
For
324071566
Rocky Mountain Bank Note

APPENDIX B

[Federal Reserve Press Release Dated December 20, 1984.]

For immediate release

The Federal Reserve Board today announced that it has extended the date for registration by companies that became bank holding companies as a result of the definition of the term "bank" in the Board's revisions to Regulation Y, which became effective on February 6, 1984. The extension will be effective until legal issues regarding the "bank" definition are resolved by Congress or the courts.

The Board similarly extended the grace period for compliance with the Bank Holding Company Act that it granted upon request of certain companies that acquired banks prior to December 10, 1982.

The Board had previously extended the registration date until December 31, 1984. A copy of the Board's order is attached.

Attachment

FEDERAL RESERVE SYSTEM

Order Extending Registration Date for Certain Bank Holding Companies

The Board is hereby extending the date for registration by companies that became bank holding companies as a result of the definition of the term "bank" in the Board's revisions to Regulation Y, which became effective on February 6, 1984. This action is being taken in view of the continued uncertainty of Congressional and judicial action regarding the bank definition. The extension will be effective until legal issues regarding the "bank" definition are resolved by Congress or the courts. The Board similarly is extending the grace period for compliance with the Bank Holding Company Act that it granted upon request of certain companies that acquired banks prior to December 10, 1982.

This action represents a continuation of the Board's previous action on July 10, 1984 extending the registration date until December 31, 1984.

By order of the Board of Governors,[1] effective December 20, 1984.

(signed) WILLIAM W. WILES

William W. Wiles
Secretary of the Board

[SEAL]

[1] Voting for this action: Chairman Volcker and Governors Martin, Wallich, Partee, Rice, Gramley, and Seger.

(10)

No. 84-1274

In the Supreme Court of the United States

OCTOBER TERM, 1985

BOARD OF GOVERNORS OF THE
FEDERAL RESERVE SYSTEM, PETITIONER

v.

DIMENSION FINANCIAL CORPORATION, ET AL.

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE TENTH CIRCUIT

REPLY BRIEF FOR THE PETITIONER

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REPLY BRIEF FOR THE PETITIONER

I. INTRODUCTION

The question in this case is whether the Board acted reasonably when, after extensive rule-making proceedings, it promulgated an amended regulation defining two undefined terms in the Bank Holding Company Act: "deposits that the depositor has a legal right to withdraw on demand" and "commercial loans."

The Board acted within its discretion under the Act in defining these terms to include NOW checking accounts and money market instruments because its definitions comport with the ordinary meaning of the statutory language and with the legislative history, which shows that Congress intended the definition of "bank" to cover any institution that performs essential commercial banking functions, *i.e.*, offering checking accounts and making short-term extensions of credit in any form to business firms.

The Board's interpretation of these terms was in response to the recent development of so-called "nonbank banks"—banks, both national and state, which seek to escape coverage under the Act through a narrow and technical reading of these terms, while offering essentially the entire range of commercial banking services. The Board's definitions give full meaning to the statutory terms in order to minimize the use of the nonbank bank device to evade the Act, based on the Board's determination that a proliferation of nonbank banks would virtually nullify the Act's fundamental purposes of separating banking from commerce and assuring local control over banking structure.

Respondents' challenge to the Board's interpretations depends on reading into the statutory language limitations not evident on the face of the statute and on the completely erroneous view that the legislative history evinces an intent to create enormous loopholes in the Act's literal coverage. Respondents also ignore the fact that

Congress conferred on the Board special authority in the broadest possible terms to "issue such orders and regulations as may be necessary to enable it to administer and carry out the purposes of this Act and to prevent evasions thereof" (12 U.S.C. 1844(b))—an explicit grant to the Board of authority to forestall evasions of the Act of the kind advocated by respondents.

Before responding in detail to the arguments that have been advanced to curtail the Board's rule-making authority under the Act, we briefly summarize the principal points of disagreement.

a. The main argument advanced by respondents and the Acting Solicitor General is that even though the Board has expansive rule-making power, which includes power to prevent "evasions" of the "purposes" of the Act, the Board's regulation must nonetheless be set aside because it constitutes administrative revision of the Act. This argument is easily put to rest. There should be no serious question that NOW accounts, embraced within the Board's regulation, are "deposits that the depositor has a legal right to withdraw on demand." As the Board explained in *First Bancorporation* (J.A. 60a), even though an institution reserves the option to require prior notice from depositors, "until the institution invokes the notice requirement, the depositor has a right to withdraw funds on demand." Beyond this, the likelihood of a call for notice is entirely theoretical. No institution ever has required—or likely ever will require—prior notification of withdrawal with respect to a NOW account in view of the destructive consequences to the institution. In these circumstances, the Board respected both economic reality and the literal language of the Act when it ruled that the "legal right to withdraw" language includes NOW accounts.

The Board was equally faithful to the literal language of the Act when it defined the term "commercial loans." Under the ordinary meaning of the words used by Congress, commercial loans encompass loans "to supply the credit needs of business enterprises * * * whatever form they take." H. Crosse and G. Hempel, *Management Policies for Commercial Banks* 192 (3d ed. 1980). The instruments included in the Board's definition each represent an extension of credit to a business—whether it be a bank or other business—for commercial purposes (Pet. App. 49a-59a). As the Board explained, "these [transactions] as a matter of law establish a debtor-creditor relationship and constitute an extension of credit or loan. Since these loans result in the provision of funds to commercial enterprises * * * and since they are not made for personal, family, household or charitable purposes, these loans are commercial loans for purposes of the bank definition of the Act" (Pet. App. 46a). Nothing on the face of the statute or in the common understanding of the language used by Congress even suggests that commercial loans are restricted solely to face-to-face transactions, as respondents have urged.

b. The Board's definitions do not rest solely on the literal language of the Act. The legislative history confirms that Congress intended the "legal right to withdraw" language to bring within the coverage of the Act all institutions that "accept deposits payable on demand (checking accounts), the commonly accepted test of whether an institution is a commercial bank." S. Rep. 1179, 89th Cong., 2d Sess. 7 (1966). This formulation was meant to encompass long-established regulatory standards under which NOW accounts were treated as demand deposits because of their checking feature even though subject to the reservation of a notice of withdrawal requirement.

Likewise, when Congress excluded institutions not making "commercial loans" from the coverage of the Act, it admonished that the Board should interpret this exemption, like all other exemptions enacted at the same time, "as narrowly as possible in order that all bank holding companies which should be covered under the Act in order to protect the public interest will, in fact, be covered." Conf. Rep. 91-1747, 91st Cong., 2d Sess. 23

(1970). The Board complied with the unambiguous mandate expressed in the legislative history when it rejected a narrow construction of the term "commercial loans" that would have allowed widespread corporate ownership of banks outside of the framework of the Act.

Stripped of excess verbiage, respondents' contention concerning the legislative history boils down to the claim that Congress intended to enact broad exceptions from the Act for large classes of institutions, regardless of their activities. Such a contention is plainly erroneous. The definition of bank prescribed in the original legislation covered virtually any bank-like institution. The 1966 amendment adding the demand deposit test was meant to exempt only limited purpose institutions that at the time performed none of the essential functions of a commercial bank. And, in 1970, when Congress broadly expanded the Act to cover one-bank holding companies, it incorporated the commercial lending test as a narrow exception to deal with "special cases" requiring "special treatment." Conf. Rep. 91-1747, *supra*, at 12, 23 (statement of House managers).

c. While respondents and the Acting Solicitor General have been quick to suggest their own definitions of the statutory terms, they have not even attempted to explain how their interpretations comport with the underlying purposes of the Act. When Congress passed the Act, it sought to prevent the "combination under single control of both banking and nonbanking enterprises." S. Rep. 1095, 84th Cong., 1st Sess. 2 (1955). It also sought "to retain local, community-based control over banking." *Northeast Bancorp* v. *Board of Governors*, No. 84-363 (June 10, 1985) slip op. 12. Both of these purposes would be entirely subverted if respondents' construction were accepted.

As the Board explained (Pet. App. 27a-31a), failure to give full scope to the statutory terms here at issue would permit an almost unlimited intermingling of banking and nonbanking business. That failure also would

permit bank holding companies to establish nationwide networks of institutions having essentially all of the characteristics of full-service commercial banks in contravention of the Act and the policies of a large number of states that oppose out-of-state entry (Pet. App. 31a).

To be sure, recent widespread attempts to exploit the commercial loan test in the Act's bank definition required the Board to reconsider past rulings regarding commercial loans. But the Board acted reasonably and properly in revisiting those rulings. It conducted a comprehensive rulemaking proceeding on all aspects of the issue and specifically identified those changes in economic conditions that compelled reconsideration. In its forty-page statement, the Board explained the reasons for reconsideration, noting that the past commercial loan rulings were not mandated by statutory language, were limited to the unique facts involved, and should not be expanded beyond those limited circumstances to permit widespread evasion of the Act. The Board's action thus falls squarely within this Court's holding that an agency "faced with new developments, or in light of reconsideration of the relevant facts and its mandate, may alter its past interpretation and overturn past administrative rulings and practice." *American Trucking Assn.* v. *Atchison, Topeka & Santa Fe Ry. Co.*, 387 U.S. 397, 416 (1967).

d. The crabbed reading of the Act urged by respondents would sap the Board's rule-making authority of necessary flexibility and open the door to serious evasions of the Act. Under respondents' interpretation, a company could evade the Act simply by causing its subsidiary bank to insert in its demand deposit contracts a theoretical and never-to-be-exercised right to require 24 hours, or even 10 minutes, advance notice. This notice provision would not affect the bank's ability to conduct all of the activities of a full-service commercial bank. Congress obviously intended the Board to have latitude to deal with such circumventions when it gave the Board

express authority to prevent "evasions" of the Act and its purposes.

In *Mourning* v. *Family Publications Service, Inc.*, 411 U.S. 356, 365, 369-374 (1973), Chief Justice Burger, speaking for the Court, pointed out that an authorization to prevent "evasion" reflects Congress' concern that regulated entities "would attempt to characterize their transactions so as to fall one step outside whatever boundary Congress attempted to establish." This reality necessitates "regulation of subject matter not specifically mentioned in the enabling legislation." *Id.* at 365, 374.

This principle applies *a fortiori* in the present case because the Board's regulation encompasses subject matter that is specifically mentioned in the statutory language and legislative history.

e. At bottom, respondents and the Department of Justice disagree with the Board on a question of regulatory policy. But in advancing this position, they ignore the fact that Congress has delegated responsibility for administration of the Act exclusively to the Board, an independent administrative agency that is expert in banking affairs and most familiar with the history and purposes of the Act. When implementing the policies of the Act, "the Board's jurisdiction is paramount." *Board of Governors* v. *First Lincolnwood Corp.*, 439 U.S. 234, 250 (1978). The Acting Solicitor General professes adherence to plain meaning, but his position is best explained as an attempt to stimulate congressional action to permit commercial ownership of banks and interstate banking by *de facto* actions that accomplish the same objectives through widespread chartering of nonbank banks. But these policy views cannot displace the reasoned decision of the Board. See *Bob Jones University* v. *United States*, 461 U.S. 574, 596 (1983). Accordingly, in this case, as in *Bob Jones*, this Court should reject the arguments of the Acting Solicitor General and sustain the regulation of the administrative agency.

II. THE BOARD'S DETERMINATION THAT NOW ACCOUNTS ARE DEMAND DEPOSITS FOR PURPOSES OF THE ACT IS CONSISTENT WITH THE LITERAL LANGUAGE AND LEGISLATIVE HISTORY OF THE ACT AND IS NECESSARY TO PREVENT EVASIONS OF ITS PURPOSES

A. Contrary to respondents' contention (AFSA Br. 13-18; SG Br. 11-12), the Board's finding that NOW accounts are demand deposits for purposes of the BHC Act is based upon the literal terms of the Act and not solely upon the functional equivalence of the two accounts. Respondents argue that NOW accounts are not "deposits that the depositor has a legal right to withdraw on demand" because they are subject to a right of the depository institution to require advance notice of withdrawal. It is undisputed, however, that in the absence of a depository institution's requirement of advance notice, a NOW account depositor has a legal right to withdraw funds on demand and the institution *is* legally obligated to pay the NOW account depositor on demand.

In theory, a depositor's legal right to withdraw from NOW accounts on demand could be terminated by a call for prior notice (Pet. Br. 31-33). This right to require prior notice, however, does not alter the fact that unless and until the notice is required, the depositor has a clear and judicially enforceable legal right to insist upon payment of funds on demand. Moreover, the likelihood of a call for prior notice on a NOW account is entirely theoretical. No depository institution ever has required notice, or is ever likely to do so, in view of the devastating effect such action would have on the institution's viability. Contrary to respondents' suggestion (AFSA Br. 15-16), depository institutions may not require notice selectively for an individual account, but must do so for *all* similar accounts (Pet. Br. 32 n.30).

Respondents attempt to portray this analysis as a "*post hoc* concoction of Board counsel" (AFSA Br. 15). But it was the Board, and not counsel, that expressly

found, in the *First Bancorporation* case (J.A. 60a), that "until the institution invokes the notice requirement, the depositor has a right to withdraw funds on demand."

Respondents and the Department of Justice seek to escape the literal meaning of the statute by arguing that, under the Board's reading of the statute, a passbook savings account would be covered as a demand deposit, a result that is in conflict with the legislative history (AFSA Br. 16 n.10; SG Br. 11 n.6). But the Board's analysis does not lead to this result. As discussed in detail below, the legislative history shows that the "legal right to withdraw" language, however broad and inclusive, was meant—in accordance with long-established and widely understood rules in effect at the time—to encompass demand checking accounts and to exclude savings accounts, such as passbook accounts, that do not have checking characteristics.

Respondents' interpretation not only clashes with the literal language of the Act, but also produces unreasonable results that would "defeat the plain purpose of the statute." See *Bob Jones University* v. *United States*, 461 U.S. at 586. Under respondents' construction, the reservation of *any* right to require notice of withdrawal—even if only for a few hours—would mean the depositor no longer has a "legal right to withdraw on demand." As a result, any commercial bank in the country could avoid coverage under the Act—without any meaningful alteration whatsoever in its banking operations—simply by inserting in its deposit contract a never-to-be-exercised right to require some notice of withdrawal. Congress did not intend the fundamental policies of the Act to depend upon such a technicality, and such a result is "plainly at variance with the policy of the legislation as a whole." *Wilshire Oil Co.* v. *Board of Governors*, 668 F.2d 732, 736-37 (3d Cir. 1981), cert. denied, 457 U.S. 1132 (1982). It is no exaggeration to say that if respondents' construction of the Act were accepted, the Act could easily become a dead letter.

B. The legislative history refutes respondents' contention that the demand deposit test was meant to exclude any deposit subject to a theoretical notice of withdrawal requirement (see Pet. Br. 26-31). The "legal right to withdraw" language was based upon, and was intended by Congress to incorporate, the distinction between demand deposits and savings accounts embedded in longstanding regulatory provisions in effect at the time (see Pet. Br. 30-31). Under these provisions, *any* deposit that could freely be drawn against by check, like a NOW account, was defined as "payable on demand," even though it was subject to a notice of withdrawal requirement. 12 C.F.R. 217.1(a), (e) (1963 and 1966 Supp.).

Thus, *at the time* the demand deposit test was added to the Act, the ability to withdraw by check, not the presence of a notice of withdrawal provision, was the decisive factor in distinguishing demand deposits (deposits payable on demand) from other types of deposits, including passbook savings accounts. This ruling had been in effect since 1935 and embodied the common understanding at the relevant time of the status of NOW accounts as demand deposits—not savings accounts. The payable on demand language, which reflected this distinction, was proposed by the Board to achieve the congressional purpose to exclude industrial banks that did not accept checking accounts of any kind, while continuing to cover commercial banks, the only institutions offering checking accounts at that time.

That Congress intended the "legal right to withdraw" language to incorporate this existing regulatory distinction is demonstrated by the fact that, in describing the statutory language, Congress equated it with the "payable on demand" language contained in the existing Board rule, and clearly stated that the language covered "checking accounts:"

> "the bill redefines 'bank' as an institution that accepts deposits payable on demand (checking ac-

counts), the commonly accepted test of whether an institution is a commercial bank * * *."

S. Rep. 1179, 89th Cong., 2d Sess. 7, 14 (1966); accord 112 Cong. Rec. 12385-86 (1966) (remarks of Sen. Robertson). In addition to this specific evidence of congressional awareness of the Board's rule, this Court traditionally presumes that Congress is aware of existing regulatory provisions when enacting statutes in the same field. See *Merrill Lynch, Pierce, Fenner & Smith* v. *Curran*, 456 U.S. 353, 379-381 (1982).

The fact that the Senate Committee Report expressly equated the statutory "legal right to withdraw" language with the proposed "payable on demand" language also demonstrates respondents' error in attributing significance to the Committee's replacement of the originally proposed terminology with the formulation actually enacted (AFSA Br. 17-18, 20; SG Br. 15 n.11). Clearly, the Act's drafters viewed these terms as interchangeable.

Respondents also argue (AFSA Br. 18-20, 22-23) that enactment of the demand deposit test in 1966 was intended to overrule a 1963 Board interpretation treating as "banks" industrial banks offering deposits that in actual practice are repaid on demand. But the error in respondents' analysis is evident. The Board's 1963 ruling by its terms plainly included institutions that offered *either* of *two* separate types of deposits: "deposits subject to check" or deposits that otherwise were in "actual practice repaid on demand" (savings accounts) (See Pet. Br. 28).

As we have shown above, the legislative history unmistakably demonstrates that Congress meant the demand deposit test to cover deposits subject to check, the first type of deposit described in the 1963 Board's ruling, and to reject only the second part of the ruling that covered institutions offering *non-checking* deposits that are repaid in practice on demand, *i.e.*, passbook savings accounts. Indeed, the industrial banking trade association that sought the demand deposit amendment testified

that industrial banks did not offer checking accounts and opposed *only* the second half of the Board's ruling, which covered institutions offering non-checking accounts:

> "The [Association], representing the companies affected, believe[s] that the *latter part* of the interpretation is improper, not within the spirit of the Act, and contrary to the intent of Congress." [1]

Thus, the association recognized that an industrial bank offering checking accounts should be covered under the Act—precisely the result achieved by the Board's regulation challenged here.

Respondents' assertion that Congress was not concerned with the nature of the instrument of withdrawal (*i.e.*, the check) (AFSA Br. 23) is refuted by the fact that every time Congress referred to the new "legal right to withdraw" language, it equated it with checking accounts (Pet. Br. 29-30). Indeed, Congress conspicuously inserted in its caption of the discussion of the new language the definitive term "checking accounts." S. Rep. 1179, *supra*, at 7.

C. Respondents' contention (AFSA Br. 21-22) that Congress intended the demand deposit test to exclude all industrial banks, regardless of their actual activities, is devoid of merit. The plain language of Section 2(c) makes clear that the services actually provided by an institution determine its status under the Act—not merely its charter. Indeed, in 1966, Congress replaced a charter test with the functional demand deposit test.

Industrial banks were excluded by the 1966 demand deposit amendment only because those institutions did not offer demand checking accounts, not because they were chartered as industrial banks. *1966 Hearings*, *supra*, at 157-158 (industrial banks only make loans to consumers and "do not accept checking accounts"). As

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[1] *Hearings on S. 2353, S. 2418, and H.R. 7371 Before a Subcomm. of the Senate Comm. on Banking and Currency*, 89th Cong., 2d Sess. 155, 157 (1966) (*1966 Hearings*) (testimony of Max A. Denney) (emphasis added).

the Board noted (Pet. App. 24a), recent legislative changes in several states have permitted industrial banks to provide both commercial loans and checking accounts, the characteristic functions of commercial banks. Institutions that exercise these powers and perform the functions of a commercial bank fall squarely within the intended ambit of the statute, regardless of the names or titles which are given to them. To the extent they are affiliated with an industrial or commercial firm, they are susceptible to the very abuses that the Act was designed to prevent.

Respondents also argue that the Board's definitions upset settled industry expectations and sweep industrial banks as a class within the coverage of the Act. There is no substance to either point. Contrary to respondents' reference to "hundreds" of covered institutions (AFSA Br. 2), only a small minority of the nation's industrial banks—approximately 53—offer NOW accounts and some of these would not be affected because they are not owned by companies.[2] The overwhelming majority of industrial banks continue to exercise only the traditional functions of those institutions—accepting savings deposits and making consumer loans—and thus are not banks under the Board's regulation. For example, in Colorado, where by far the greatest number of affected industrial banks are located, only 26 of 141 industrial banks accept NOW accounts, and NOW accounts represent less than one percent of the total assets of all industrial banks in the State. Colorado State Bank Commissioner, Seventy-fifth Annual Report 211-352 (1984). None of the industrial banks controlled by respondent Household Finance Corporation in Colorado currently offers NOW accounts (*ibid.*).

D. Respondents' reliance on several legislative and regulatory developments, each occurring after the 1966

[2] *Hearings on S. 2181 and S. 2134 Before the Senate Comm. on Banking, Housing, and Urban Affairs*, 98th Cong., 2d Sess. 1643 (1984) (Part III) (Appendix B to testimony of Board Chairman Volcker).

Amendments (AFSA Br. 16-18, 28-35), is completely misplaced. Interpretation of the BHC Act must be based on its language and legislative history, not on subsequent developments. See *Consumer Product Safety Commission* v. *GTE Sylvania, Inc.*, 447 U.S. 102, 117 (1980). And none of these subsequent developments—most of which are unrelated to the BHC Act—even remotely undermines the reasonableness of the Board's determination that NOW accounts must be treated as demand deposits to effectuate the purposes of the Act.

Contrary to respondents' assertions (AFSA Br. 11, 16-17; SG Br. 7, 14), the Board has *never* ruled, either before 1966 or thereafter, that NOW accounts are not demand deposits for purposes of the BHC Act. In March 1982, in its *First Bancorporation* decision (J.A. 59A-64A), the first case that raised the issue after NOW accounts were authorized on a nationwide basis in December 1980, the Board ruled that NOW accounts must be treated as demand deposits under the Act. It is true that the Board previously declined to treat as "banks" a handful of unique institutions chartered under New Hampshire law as guaranty savings banks (see AFSA Br. 16-17; SG Br. 14). The Board's decision, however, did not rest on a finding that NOW accounts are not demand deposits. Instead, the Board found that—unlike many of the industrial bank respondents here—the guaranty savings banks did *not* engage in the full range of commercial lending functions, but concentrated their lending in the residential mortgage area, like traditional savings and loan associations. *First NH Banks, Inc.*, 69 Fed. Res. Bull. 874, 875 (1983).

It is true, as respondents point out, that in authorizing NOW accounts on a nationwide basis in 1980, Congress noted that NOW accounts are subject to a notice of withdrawal requirement (AFSA Br. 29-30; SG Br. 13, n.8). But Congress also plainly recognized at the same time that NOW accounts are functionally equivalent to conventional demand deposits and must be regulated as

such in order to forestall evasion of legal requirements relating to demand deposits. S. Rep. 96-368, 96th Cong., 1st Sess. 5 (1979) (NOW accounts "are the functional equivalent of interest bearing checking accounts"); Pet. Br. 35-36.

The fact that NOW accounts are currently denominated as savings deposits under interest rate limitation and reserve requirement regulations (AFSA Br. 31-34) is not relevant. The decisive fact is that, at the time Congress adopted the demand deposit test, NOW accounts were defined as, and widely understood to be, demand deposits. Moreover, NOW accounts currently are classified as savings deposits for reserve requirement purposes in name only. They are treated as the equivalent of demand deposits pursuant to express congressional direction (Pet. Br. 36-37). The current classification of NOW accounts under interest rate limitation regulations simply provides a convenient method to specify the maximum interest rate to be paid on these accounts. The crucial fact is that Congress considered NOW accounts as demand deposits and authorized them *only* as an exception to the general federal prohibition on the payment of interest on demand deposits (*id.*, 35-36).

E. Respondents attack the Board's finding that NOW accounts must be treated as demand deposits in order to prevent evasions of the Act. They cite the self-evident proposition that the exercise of delegated power to prevent evasions of a statute may not reach conduct Congress did not intend to cover (AFSA Br. 26; SG. Br. 26 n.25). But the broad power Congress has granted the Board to prevent evasions of the Act reaches the obvious circumvention of the purposes of the Act involved here. This Court has recognized that an agency may exercise its authority to prevent evasions of a statute to reach even "matters not specifically mentioned in the enabling legislation," where necessary to prevent the statute from being frustrated. *Mourning* v. *Family Publications Service, Inc.*, 411 U.S. 356, 374 (1973); *see Gemsco, Inc.* v. *Walling*, 324 U.S. 244, 255 (1945).

In 1966, Congress could not have foreseen the extent to which the subsequent authorization of NOW accounts would undermine the Act's objectives. Congress intended the Board to have flexibility to adapt regulatory requirements to evolving technological developments in the financial services industry. See *United States* v. *Southwestern Cable Co.*, 392 U.S. 157, 172 (1968).

In the context here at issue, the need for resolving doubts in favor of statutory coverage to effectuate congressional intent has explicitly been recognized in a well-reasoned opinion of the Third Circuit holding that a bank may not escape coverage under the Act simply by converting its demand deposits into notice-of-withdrawal checking accounts. *Wilshire Oil Co., supra.* The rationale of the *Wilshire* decision is applicable to NOW accounts whether or not they are offered to corporate depositors. In amending the Act to cover all institutions that offer "checking accounts" (S. Rep. 1179, *supra*, at 7), Congress made no distinction regarding the type of depositor holding such accounts. There is good reason for this: just like funds from corporate accounts, funds made available to an institution through NOW accounts can be used to engage in the kinds of discriminatory credit practices that Congress meant to eliminate when it enacted the BHC Act.

III. THE BOARD'S DETERMINATION THAT EXTENSIONS OF CREDIT TO BUSINESSES THROUGH MONEY MARKET INSTRUMENTS CONSTITUTE COMMERCIAL LENDING IS CONSISTENT WITH THE LITERAL LANGUAGE AND LEGISLATIVE HISTORY OF THE ACT AND IS NECESSARY TO PREVENT EVASION OF ITS PURPOSES

A. There is absolutely no support in the "ordinary meaning" of the statutory language for respondents' assertion that a bank engaged in the business of extending short-term credit to commercial enterprises by purchasing money market instruments is not engaged in commercial lending (and thus is not a "bank" under the Act) because it does not engage in "direct negotiations"

with borrowers (Dimension Br. 16-17; SG Br. 16-17). Certainly, the bank definition in the Act by its terms nowhere requires direct negotiations as a prerequisite to being "engage[d] in the business of making commercial loans." Nor does anything in the usual meaning of the words employed in the statute even hint at such a restriction. To "make" ordinarily means to perform, do, or effect. See *Webster's New International Dictionary* 1485 (2d ed. 1959). A "loan" is simply a sum of money lent at interest. See *id.*, at 1447. A "commercial" loan is one related to business or trade. See *id.* at 538. It is therefore evident from the face of the statute that Congress selected broad and generic—not restrictive—terminology in defining the requisite type of lending activity covered by the Act.

Respondents are in error in suggesting that there is, or was at the time the commercial lending test was added to the Act, some clearly-defined usage in the banking industry that would exclude all extensions of credit to businesses except those involving face-to-face dealings. To the contrary, the general understanding of the term "commercial loans" in the banking industry—both at the time of the commercial lending amendment and now—encompasses any loan, in whatever form, made to supply the credit needs of a business concern:

> "the foremost obligation of a commercial bank is to supply the credit needs of business enterprises, including farm operations, in its community. Loans that accomplish this general purpose, *whatever form they take,* are essentially commercial loans."

H. Crosse and G. Hempel, *Management Policies for Commercial Banks* 192 (3d ed. 1980) (emphasis added); accord G. Munn & F. Garcia, *Encyclopedia of Banking and Finance* 522 (8th ed. 1983); *id.*, at 421 (6th ed. 1962); L. Davids, *Dictionary of Banking and Finance* 51 (1978).

Moreover, the boundaries of transactions understood to be commercial loans never have been delineated with precision. According to an authority cited by the Justice Department:

> "A precise definition of 'business loans' is difficult because of their heterogenous character. Historical data * * * are often not available on a consistent basis * * *. Even for the more recent period, business loans have been defined in various ways for different purposes."

American Bankers Association, *The Commercial Banking Industry* 121 (1962); accord, B. Beckhart, *Business Loans of American Commercial Banks* 3 (1959) (business loans are "difficult to define and even to identify in bank portfolios").

None of the authorities relied on by respondents and the Justice Department expressly states that face-to-face negotiations are an indispensable attribute of a commercial lending transaction. Moreover, the Justice Department errs in suggesting (Br. 18) that the Comptroller of the Currency and the FDIC criticized the Board's definition as inconsistent with accepted industry usage. As explained *infra*, these agencies' objections were premised primarily on policy grounds.

Finally, we note that even respondents cannot dispute that purchases of the money market instruments described in the Board's regulation fall within the scope of transactions encompassed by the ordinary meaning of this statutory language: extensions of credit to businesses for short-term working capital needs. See B. Beckhart, *supra*, at 3 (business loans may include "acceptances and commercial paper purchased in the open market, as well as promissory notes"). The fact that certain of these instruments involve extensions of credit to a bank does not make these instruments any less commercial loans within the meaning of the Act, since a bank clearly is a business enterprise.

B. Respondents' self-serving interpretation of "commercial loans" also runs afoul of the unqualified legislative directive in the statement of the House managers in the Conference Report that the commercial loan provision (and all other exemptions enacted at that time)

must be "interpret[ed] * * * as narrowly as possible in order that all bank holding companies which should be covered under the Act in order to protect the public interest will, in fact, be covered." Conf. Rep. 91-1747, 91st Cong., 2d Sess. 23 (1970). This directive to the Board demonstrates a congressional recognition that the "commercial loans" exemption is not a self-executing provision based on some clearly defined industry standard, as respondents claim, but is a provision that must be "interpreted" by the expert administrative agency in order to effectuate Congress' intent.

In addition, the House managers recognized that the commercial loan provision would "apply to a very small number of special cases that, it is felt, require special treatment" (*ibid.*). Contrary to respondents' assertion (Dimension Br. 19 n.17), the statement by the House conferees on the narrow scope of the commercial loan exemption constitutes an accurate reflection of legislative will. Disagreements among the conferees concerned other matters. 116 Cong. Rec. 41954 (1970) (remarks of Rep. Widnall); see *Board of Governors* v. *Investment Company Institute*, 450 U.S. 46, 73 n.54 (1981).

Respondents' reliance (Dimension Br. 19-21) on the money market activities conducted by the Boston Safe Deposit and Trust Company, the one trust company expected to be affected by the commercial lending test, is misplaced. Respondents offer not the slightest evidence that Congress was aware of each of the various activities conducted by Boston Safe. Congress held no hearings and conducted no inquiry into Boston Safe's activities. The *only* representation made to Congress regarding Boston Safe's activities was that it was a fiduciary institution, primarily engaged in managing trusts. *1966 Hearings, supra*, at 732. Moreover, Congress acted in reliance on the Board's representation that the exemption for non-commercial lending institutions would be of limited scope, "possibly affecting only one institution" (see Pet. Br. 41). In such circumstances, respondents' *post hoc*

arguments about the functions of the institution that was the intended beneficiary of the exemption is no substitute for the ordinary meaning of the words Congress enacted and the congressional injunction that they be narrowly construed.

C. Nor is there any merit to the contention that the Act's purposes are consistent with respondents' restrictive reading of "commercial loans." The fact that the commercial lending test was adopted in 1970 with little legislative discussion and was uniformly understood to create no significant loophole in the Act demonstrates that the exemption was not intended to be a significant retreat from Congress' basic objectives. The Board's construction of the statutory language to include all extensions of credit to businesses, whether direct or indirect, is necessary to assure, as far as is consistent with the literal language of the statute, that all of the Act's purposes are fully carried out.

Even if, as respondents assert, the terms of money market instruments were relatively standardized and rates were dependent on market forces—which often is not the case—in times of credit shortage a nonbank bank controlled by a retail enterprise, for example, could use its funds to purchase commercial paper or bankers' acceptances of its affiliated retail business in order to finance its operations, while refusing to purchase similar obligations of non-affiliated competitors. As we have shown (Pet. Br. 19-20), Congress proscribed the combination of banking and unrelated business to forestall preferential and discriminatory practices in the granting of credit. *E.g.*, 12 U.S.C. 1971, 1972; S. Rep. 91-1084, 91st Cong., 2d Sess. 3 (1970) (1970 Senate Report) (quoting remarks of Board Chairman Martin) (when banking and nonbanking businesses are combined, credit will be more available to customers of affiliated firms than to customers of unaffiliated firms). Contrary to respondents' claim (Dimension Br. 17), the potential for discriminatory practices inherent in the purchase of

money market instruments exists when credit is extended to a bank as well as to other types of businesses.

Moreover, as we have demonstrated, the restrictive reading of "commercial loans" advanced by respondents would significantly undermine the goal of the Douglas Amendment to "retain local, community-based control over banking." See *Northeast Bancorp* v. *Board of Governors*, No. 84-363 (June 10, 1985), slip op. 12. Respondents' reading would permit the establishment of multistate networks of NOW checking account-commercial lending banks despite the vigorous opposition of a number of affected states. Dimension's response (Br. 43) that Congress did not mean the Act to apply to Dimension because it is not one of the "established banking giants" is clearly wrong because the Act expressly applies to both large and small banks and Congress specifically rejected an exemption for small banks (see Pet. Br. 42). Dimension's argument also misses the point because, under the logic of Dimension's own argument, the nation's largest banking organizations would be permitted to construct exactly the same kind of interstate banking network as Dimension proposes. Similarly, the fact the respondent-intervenor Household Finance Corporation and *amicus* Sears, Roebuck & Co., which are among the nation's largest business organizations and which have extensive networks of nonbanking affiliates, control only relatively small banks does not negate the potential for the discriminatory credit practices the Act was designed to prevent.

The fact that nonbank banks themselves are subject to regulation by bank supervisors (Dimension Br. 41) is of course immaterial. The BHC Act is an independent regulatory framework that reflects Congress' determination that *holding companies* and *affiliates* of banks must also be supervised in order to protect the nation's financial system (see Pet. Br. 22-24).

Amicus Sears, Roebuck & Co. errs in characterizing as a "fiction" Congress' repeatedly-declared policy of separating banking from commerce (Br. 3, 7-8). It is beyond dispute that the BHC Act "was intended to implement a congressional policy against control of banking and nonbanking enterprises by a single business entity." *Lewis* v. *BT Investment Managers, Inc.*, 447 U.S. 27, 46 (1980); accord, S. Rep. 1095, 84th Cong., 1st Sess. 2 (1955); 1970 Senate Report, *supra*, at 2 (the combination under single control of banking and nonbanking enterprises departs from the "established policy of separating banking from other commercial enterprises").

D. Contrary to respondents' contention (Dimension Br. 22-27), the Board provided a reasoned basis for not relying on several early administrative interpretations of limited applicability. As the Board explained (Pet. App. 59a), these early rulings establish the same broad test for "commercial loans" prescribed in the regulation at issue here. And the exceptions that they granted were by their own terms of limited applicability and pertained only to the special circumstances there at issue.

In its first ruling, rendered only shortly after passage of the Act, the Board stated that commercial loans encompass

> "all loans to a company or individual, secured or unsecured, other than a loan the proceeds of which are used to acquire property or services used by the borrower for his own personal, family, or household purposes, or for charitable purposes." [3]

This interpretation, which has remained the touchstone of the Board's application of the Act's commercial loan provision, was reaffirmed in the Board's June 1972 letter regarding Boston Safe's status under the Act. In that letter, the Board found that Boston Safe was "principally engaged in a trust business" (J.A. 93A) and concluded that "in the circumstances of this case" money market instruments, such as certificates of deposit, commercial paper, and bankers' acceptances, and the sale

[3] Letter, dated July 1, 1971, from the Board to Greater Providence Deposit Corp.

of federal funds would not be regarded as commercial loans (J.A. 94A).

Clearly, this ruling represents an *ad hoc* judgment based on the Board's enforcement discretion and its view that the purposes of the Act would not be impaired in the particular circumstances involved. The same limitations are inherent in the Board's ruling that certificates of deposit purchased by a subsidiary bank of Chrysler Corporation chartered for the sole purpose of collecting drafts drawn on car dealers were not commercial loans. This ruling was based on the unique circumstances involved—in particular, Chrysler's strained financial condition and the enactment of a federal statute designed to prevent Chrysler's failure.[4] Even in this special situation, however, the Board prohibited the purchase of commercial paper and bankers' acceptances. Finally, the Board's letter to Gulf and Western Corporation (J.A. 110A-112A), also relied on by respondents, made no mention of money market instruments.[5]

The Board's reconsideration of these early views included a formal rulemaking proceeding. After careful consideration of the record, the Board concluded that the earlier, restrictive reading of "commercial loans" is not required by the statutory language or history and, judged in light of current circumstances, fails to give effect to Congress' intent. The Board also found that these early rulings did not—and had no occasion to—consider the extent to which the Act would be evaded if the rulings were exploited by nonbanking companies as a means to acquire commercial banks whose only purpose in substituting money market instruments for other commercial loans was to enable their parent companies to escape

[4] [1981-1982 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 98770.

[5] The staff letters cited by respondents (J.A. 99A-105A) state a rationale for excluding certain loans based on the existence of face-to-face negotiations that never has been embraced by the Board and that has no basis in the statutory language.

the Act. In these circumstances, the Board acted reasonably in clarifying its past pronouncements and construing the Act in its contemporaneous economic context. See *Motor Vehicle Manufacturers Association* v. *State Farm Mutual Automobile Insurance Co.*, 463 U.S. 29, 42 (1983) (agencies must be given "ample latitude to 'adapt their rules and policies to the demands of changing circumstances' ").

IV. THE BOARD'S VIEWS ON THE INTENT AND PURPOSES OF THE ACT ARE ENTITLED TO DEFERENCE

Respondents advance a variety of contentions to attack the well-founded principle that the Board's exercise of its broad power to administer and prevent evasion of the Act is entitled to judicial deference. Each of these assertions is unpersuasive.

A. The Justice Department's assertion that the Board's action somehow upsets the "delicate balance" among government regulatory agencies (Br. 2) misrepresents the regulatory framework established by Congress and distorts the effect of the Board's action. The administration of the BHC Act is a matter committed specifically and exclusively to the Board. See *Whitney National Bank* v. *Bank of New Orleans and Trust Co.*, 379 U.S. 411, 419 (1965); *Board of Governors* v. *First Lincolnwood Corp.*, 439 U.S. 234, 250 (1978). Moreover, the Board's rule regulates the corporate owners of banks. The rule in no way infringes the regulatory responsibilities of the FDIC or the Office of the Comptroller of the Currency (OCC), which share responsibilities at the federal level with the Board for the supervision of *banks*.

Consequently, it is evident that the objection of these agencies to the Board's regulation is premised primarily on their belief that the reasons for Congress' adoption of the Act are no longer valid in light of current industry conditions. Indeed, the FDIC, while objecting to the Board's action on policy grounds, does not question the Board's authority to adopt the challenged regulation

under existing law (SG Br. 18). The OCC's analysis of the Act is plainly colored by that agency's oft-repeated view that, in light of recent marketplace developments, existing regulatory restrictions governing the banking industry must be significantly relaxed (*e.g.*, *Hearings on H.R. 5734 Before the House Comm. on Banking, Finance and Urban Affairs*, 98th Cong., 2d Sess. 1623-1633 (1984) (testimony of C.T. Conover)) and its statement that it would charter nonbank banks to stimulate congressional expansion of national bank powers. Statement by C.T. Conover, Comptroller of the Currency, News Release 84-42 (May 9, 1984). The OCC has subsequently chartered nonbank banks on a large scale, where the only purpose of the charter is to avoid either the restrictions on combining banking and commerce or interstate restrictions in the BHC Act (see Pet. Br. 24-25). Moreover, the Federal Home Loan Bank Board believes that the Board's definitions are within its "clear authority" under the Act and necessary to carry out its purposes. See Appendix, *infra.*

The Justice Department's decision to oppose a client agency can only be explained as an attempt to further the policy goals reflected in the OCC's statements. But it is the Board, an independent agency, to which Congress has delegated administration of the BHC Act. And it is the Board's view that should be accorded deference.

B. Respondents' assertion that the Board's definitions will cause a "dramatic change" in the current structure of the banking system (AFSA Br. 40; Dimension Br. 49, SG Br. 27-28) is totally without factual support. On the contrary, acceptance of respondents' and the Justice Department's position regarding the nonbank bank device would result in a fundamental and dramatic change in the structure of the banking system in the United States without congressional authorization or consideration of the underlying safety and soundness and other policy issues.

The Board's definitions do not upset settled practices of industrial banks (see pp. 11-12, *supra*). Moreover, the few companies affected need only cause their subsidiary industrial banks to cease offering NOW accounts or register as bank holding companies.

The impact of the Board's determination on savings and loan associations that are not federally insured is minimal. For all practical purposes, this class of institutions is no longer in existence, given the regulatory and industry reaction to panic withdrawals experienced by such institutions in Ohio and Maryland (Pet. Br. 23 n.16). State laws in Ohio and Maryland now require virtually all savings associations to obtain federal deposit insurance (*ibid.*). In North Carolina and Massachusetts, privately insured thrift institutions have obtained or have applied to obtain federal insurance.[6] In California and Pennsylvania, state authorities have strongly encouraged privately insured institutions to obtain federal insurance and in the remaining states, Kansas and Iowa, we have been advised that there are no privately insured institutions that currently offer NOW accounts.[7]

Finally, virtually all of the nonbank banks that are chartered as commercial banks but that voluntarily forego either offering demand deposits or making commercial loans to avoid status as banks under the Act, such as those formed by respondent Dimension, came into existence after 1982. Thus, they knew, or should have known, the effect that the Board's current construction of the bank definition would have on their operations.

C. Respondents also err in contending that the Board's determination usurps a legislative function (AFSA Br. 38-41; Dimension Br. 45-50; SG Br. 25-29). By its terms, the Board's action here is grounded squarely on factors within the Board's expertise as the administrator of the statute: an analysis of the language, history, and purpose of the Act as applied to specific financial trans-

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[6] Pet. Br. 23 n.16; Am. Banker, Aug. 27, 1985, p. 3.

[7] 1985 Cal. Legis. Serv. 991-992 (West); Am. Banker, Aug. 23, 1985, p. 2.

actions, as well as the exercise of express authority delegated to the Board to prohibit "evasions" of the statute (Pet. App. 32a-61a). By contrast, if respondents' interpretation of the Act were adopted, the discretion of Congress to legislate would be severally impaired by a flood of newly created nonbank banks claiming a vested interest in the *status quo*. The overwhelming weight of current congressional opinion recognizes that the nonbank bank device is contrary to the fundamental policies of Congress and frustrates the operation of existing law. See, *e.g.*, H.R. Rep. 98-889, 98th Cong., 2d Sess. 9 (1984) (nonbank banks are "designed to avoid the impact of certain banking laws and make it impossible to enforce the spirit of those laws"); 130 Cong. Rec. S 13562 (daily ed. Oct. 4, 1984) (joint statement of Chairmen of Senate and House banking committees declaring that new nonbank banks will *not* be grandfathered by new legislation governing this subject).

The fact that Congress has not yet enacted new legislation dealing with nonbank banks has little probative value. Congress' failure to enact bills relating to an existing statute does not demonstrate "a congressional construction of the meaning of the statute;" and the "advocacy of [new] legislation by an administrative agency * * * is an unsure and unreliable, and not a highly desirable, guide to statutory construction." *American Trucking Assn.* v. *Atchison, Topeka & Santa Fe Ry. Co.*, 387 U.S. 397, 417-418 (1967). In addition, Congress may well be satisfied with present regulatory and judicial actions limiting nonbank banks. Finally, proposed legislation now before Congress would have a far greater effect on the industry (by applying the Act to *all* FDIC-insured banks regardless of their activities (see H.R. Rep. 98-889, *supra*, at 11)) than would the Board's limited administrative action.

* * *

The nation's financial system is a highly complex and technical one, influenced by a host of rapidly changing and interrelated economic factors and subject to potentially severe strains. Rather than regulating that system itself, Congress has committed governance of critical aspects of the system to an expert and independent agency accompanied by an expansive grant of authority to carry out the legislative purpose. When, as in the present case, the agency takes action that is designed to preserve the integrity of the regulatory framework and that accords with the will of Congress, as expressed in the statutory language and legislative history, that action should be upheld. As Justice Rutledge explained in *Board of Governors* v. *Agnew*, 329 U.S. 441, 450 (1947) (concurring opinion):

> "Not only because Congress has committed the system's operations to [the Board's] hands, but also because the system itself is a highly specialized and technical one, requiring expert and coordinated management in all its phases, I think their judgment should be conclusive upon any matter which, like this one, is open to reasonable difference of opinion."

For the foregoing reasons and the reasons set forth in petitioner's opening brief, the judgment of the court of appeals should be reversed.

Respectfully submitted.

OCTOBER 1985

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I authorize the filing of this brief.

CHARLES FRIED
Acting Solicitor General

APPENDIX

FEDERAL HOME LOAN BANK BOARD

NORMAN H. RAIDEN
General Counsel

Mr. Michael Bradfield
General Counsel
Federal Reserve Board
20th and Constitution Ave., N.W.
Washington, D.C. 20551

Re: *Board of Governors v. Dimension Financial Corporation, et al.*, No. 84-1274 (U.S. Supreme Court)

Dear Mr. Bradfield:

The Bank Board would like to express its support for the position taken by the Board of Governors before the Supreme Court in the above-captioned case.

The Board of Governors has obtained Supreme Court review of the decision of the Court of Appeals for the Tenth Circuit, striking down the Board's rule interpreting the definition of a "bank" in the Bank Holding Company Act of 1956 ("BHCA"). 12 U.S.C. § 1841(c). That interpretation, at 12 C.F.R. § 225.2(a)(1), would have brought many "non-bank banks" into the scope of the BHCA and subjected the companies that control them to regulation by the Board of Governors as bank holding companies. The Bank Board agrees with the Board of Governors that it has clear authority to adopt this rule under section 5(b) of the BHCA, which charges the Board "with exclusive authority to administer the BHCA and to issue such orders or regulations as may be neces-

sary to enable it to carry out the purposes of the BHCA and to prevent evasions thereof." 12 U.S.C. § 1844(b).

The Bank Board shares the conviction of the Board of Governors that the current proliferation of "non-bank banks" constitutes a serious evasion of the comprehensive scheme of federal regulation of financial institutions. Such institutions operate as the functional equivalents of commercial banks wholly outside of the federal laws governing the operations of banks or savings and loan associations. The exploitation of this "loophole" has caused dramatic changes in the financial services industry with none of the stabilizing safeguards that historically have accompanied the passage of significant deregulatory legislation. Of particular concern to the Bank Board is the ability of these institutions to operate nationwide, notwithstanding Congressional policy strictly delimiting the interstate operation of commercial banks and thrift institutions set out in the BHCA and the Garn-St Germain Depository Institutions Act of 1982 ("the Garn Act").

Through this evasion of federal law, the growth of "non-bank banks" has in fact already seriously jeopardized the ability of the FSLIC to resolve problem cases through less costly interstate acquisitions. Section 123 of the Garn Act granted the Bank Board the enhanced authority to arrange interstate acquisitions of thrifts in supervisory cases, dramatically reducing the cost of these cases to the FSLIC. The ability of companies to operate financial institutions interstate as "non-bank banks," immune from federal regulations on interstate operation, has greatly lessened interest in thrift acquisitions by potential acquirers, frustrating the intent of Congress in the Garn Act to enable the FSLIC to utilize its limited interstate franchise powers to bolster the ailing FSLIC fund.

In striking down the rule, the Court of Appeals failed entirely to appreciate that non-bank banks in fact constitute a serious evasion of the BHCA, both as to interstate operation and mingling of banking and non-banking activities. The fact that the Board of Governors' previous interpretation of the BHCA permitted the development of these institutions does not, as the Court of Appeals concluded, indicate that the operation of non-bank banks cannot now constitute an evasion of the BHCA. That previous interpretation had repercussions on the financial services industry that the Board of Governors could not foresee. The Supreme Court has long recognized that federal agencies "must be given ample latitude to 'adapt their rules and policies to the demands of changing circumstances,' *Permian Basin Area Rate Cases*, 390 U.S. 747, 784 (1968)." *Motor Vehicle Manufacturers Ass'n v. State Farm Automobile Insurance Co.*, 463 U.S. 29, 42 (1983). This flexibility is crucial for financial regulatory agencies, which must respond to a technological revolution in the financial services industry and the growth of competitive pressures that could not have been anticipated even a decade ago.

While the Bank Board has urged Congressional action on the non-bank bank issue, it strongly disagrees with the conclusion of the Court of Appeals that the Board is helpless to deal with an obvious "evasion" of the purposes of the BHCA until Congress acts. It is the responsibility of the Board of Governors and the other financial regulatory agencies to consider the entirely new issues raised by the growth of "non-bank banks" in interpreting federal banking law and in carrying out their statutory duties. In the view of the Bank Board, the challenged rule constituted a reasonable and reasoned interpretation of the BHCA, and a thoughtful, rational response to the "non-bank bank" problem. That interpretation accurately reflected the fact that "non-bank banks" provide services and make investments that are the functional equivalent of demand deposits and "commercial loans" and that appropriately should bring them within

the ambit of the BHCA. The Court of Appeals should have accorded this interpretation substantial deference, as a regulation issued pursuant to an express delegation of rulemaking authority by an expert administrative agency. *See Securities Industry Association v. Board of Governors*, No. 83-614, (June 28, 1984) slip op. 8.

In sum, the Bank Board fully supports the position of the Board of Governors before the Supreme Court in this case.

Very truly yours,

/s/ Norman H. Raiden
NORMAN H. RAIDEN
General Counsel

No. 84-1274

IN THE
Supreme Court of the United States
OCTOBER TERM, 1985

BOARD OF GOVERNORS OF THE
FEDERAL RESERVE SYSTEM,
Petitioner,
v.
DIMENSION FINANCIAL CORP., *et al.*,
Respondents.

**On Writ of Certiorari to the United States
Court of Appeals for the Tenth Circuit**

BRIEF OF CONFERENCE OF STATE BANK SUPERVISORS, FLORIDA BANKERS ASSOCIATION AND OKLAHOMA BANKERS ASSOCIATION AS *AMICI CURIAE* IN SUPPORT OF THE PETITIONER

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QUESTIONS PRESENTED

1. Whether the court below erred in holding, based upon the literal terms of Section 2(c) of the Bank Holding Company Act, that the Federal Reserve Board's regulation defining "bank" for purposes of the Act was invalid, where the record demonstrates that the Board's regulation is plainly consistent with congressional intent as manifested in the overall purposes of the Act and the legislative history of Section 2(c).

2. Whether the court below erred in holding that the Board exceeded its rulemaking authority under Section 5(b) of the Act, which empowers the Board to issue rules "to carry out the purposes of [the Act] and to prevent evasions thereof," where the Board specifically determined that its regulation was necessary to restrain the growth of so-called "nonbank banks" whose expansion threatened to evade, and thereby undermine, the purposes of the Act.

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IN THE
Supreme Court of the United States
OCTOBER TERM, 1985

No. 84-1274

BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM,
Petitioner,
v.
DIMENSION FINANCIAL CORP., *et al.*,
Respondents.

On Writ of Certiorari to the United States Court of Appeals for the Tenth Circuit

BRIEF OF CONFERENCE OF STATE BANK SUPERVISORS, FLORIDA BANKERS ASSOCIATION AND OKLAHOMA BANKERS ASSOCIATION AS *AMICI CURIAE* IN SUPPORT OF THE PETITIONER

INTEREST OF *AMICI CURIAE*

This brief is filed by the Conference of State Bank Supervisors (the "Conference"), the Florida Bankers Association and the Oklahoma Bankers Association (collectively, the "Associations"), with the consent of all parties,[1] in support of the Petitioner. The Conference is the professional association of state government officials responsible for regulating more than 10,000 state-chartered banking institutions, with total assets of approximately $1 trillion, in the 50 states and in Guam, Puerto Rico and the Virgin Islands.[2] The Associations are mem-

[1] Letters indicating the consent of all parties to the filing of this brief have been filed with the Clerk.

[2] In 1958, the Conference invited state-chartered banks to become "associate members," and there are currently about 3,600 such associate members. Associate members, however, may not vote at meetings of the Conference and therefore do not vote on decisions or policies of the Conference.

bership organizations representing more than ninety percent of the commercial banks headquartered in Florida and Oklahoma, respectively.

The members of the Conference and the Associations have a vital interest in the outcome of this case. The decision of the court below would allow institutions known as "nonbank banks" to be acquired and operated by commercial organizations and bank holding companies without regard to the requirements of the Bank Holding Company Act, 12 U.S.C. §§ 1841-50 (the "BHC Act"). Since 1980, nonbank banks—which, purportedly, either do not accept demand deposits or do not make commercial loans—have proliferated across the country. These entities claim that they are not "banks" by virtue of the 1970 amendment to Section 2(c) of the BHC Act, 12 U.S.C. § 1841(c), which modified the definition of "bank" to include each institution which "accepts deposits that the depositor has a legal right to withdraw on demand" and "engages in the business of making commercial loans." Nonetheless, nonbank banks are chartered as banks and provide services identical to many of the services offered by full-service commercial banks.

The Conference and the Associations are particularly concerned about the manner in which both bank and nonbank holding companies have sought to establish nonbank banks across state lines without state permission, notwithstanding Section 3(d) of the BHC Act, 12 U.S.C. § 1842(d) (popularly known as the "Douglas Amendment"), which requires specific state authorization for each interstate acquisition of a deposit-taking bank.[3] In addition, the operation of nonbank banks by organizations engaged in securities and other nonbanking activities would place commercial banks (such as those which are members of the Associations) at an unfair disadvantage, since such banks and their parent bank holding companies are prohibited from engaging in many of the activities conducted by nonbanking organizations.

[3] *See* Argument, Part I(A)(1), *infra*.

The Conference and the Florida Bankers Association have an additional, collateral interest in this case. The court below considered the legislative history of the 1970 amendment to Section 2(c) the BHC Act and concluded that the amendment "permitted the development of the non-bank banks."[4] Thus, the court *assumed* the lawfulness of nonbank banks and was only concerned with the permissible scope of their operations. Subsequently, however, the Eleventh Circuit Court of Appeals, in a case in which the foregoing *amici* were parties, reviewed the same legislative history and reached a very different conclusion—*viz.*, that the 1970 amendment was intended to exempt from the BHC Act only "a single intrastate institution [the Boston Safe Deposit and Trust Company]—or perhaps the very few entities similarly situated." *Florida Dept. of Banking & Finance v. Bd. of Governors of Fed. Reserve Sys.*, 760 F.2d 1135, 1142 (11th Cir. 1985). The Eleventh Circuit also considered the Douglas Amendment (a provision which the Tenth Circuit expressly *declined* to consider, 744 F.2d at 1410), and held that the 1970 amendment could *not* be construed to permit bank holding companies to establish deposit-taking nonbank banks across state lines without state authorization pursuant to the Douglas Amendment.

The Intervenor-Respondent in *Florida Dept. of Banking*, U.S. Trust Corporation, has indicated that it will petition this Court for a writ of certiorari. Only the Tenth Circuit's decision is before this Court and is argued in this brief. However, *amici* have an understandable concern with respect to the possible effect of this

[4] *Dimension Financial Corp v. Bd. of Governors of Fed. Res. Sys.*, 744 F.2d 1402 (10th Cir. 1984), Appendix to Petition for Certiorari ("App.") 1a-19a, at 1407, App. 9a, *cert. granted*, 105 S.Ct. 2137 (1985).

Court's decision in the present case upon the Eleventh Circuit's decision.

INTRODUCTION AND SUMMARY OF ARGUMENT

1. The Federal Reserve Board's Regulation

The court below held that the Federal Reserve Board (the "Board") acted beyond the scope of its authority under the BHC Act in adopting a definition of "bank" as part of the Board's revision of Regulation Y in January 1984.[5] The Board defined "bank," for purposes of the BHC Act, to include every institution which engages in the twin functions specified by Congress in its 1970 amendment to Section 2(c) of the BHC Act, *viz.*, the acceptance of "demand deposits" and the making of "commercial loans."[6] The Board defined "demand deposits" to include all deposit accounts payable in practice on demand and withdrawable by check or other negotiable instrument, and defined "commercial loans" to include all loans except those made to individuals for personal, family, household, or charitable purposes. The Board's definition of "commercial loans" included money market transactions such as the purchase of certificates of deposit and bankers' acceptances and the sale of federal funds.[7]

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[5] *See* Board Revision of Regulation Y, 49 Fed. Reg. 794, 818-19 (1984).

[6] Section 2(c) of the BHC Act defines "bank," in pertinent part, as any institution "which (1) accepts deposits that the depositor has a legal right to withdraw on demand, and (2) engages in the business of making commercial loans." 12 U.S.C. § 1841(c).

[7] The Board's definitions of "demand deposits" and "commercial loans" are as follows:

(A) "Deposits that the depositor has a legal right to withdraw on demand" (hereinafter "demand deposits") means any deposit with transactional capability that, as a matter of practice, is payable on demand and that is withdrawable by check, draft, negotiable order of withdrawal or other similar instrument; and

(B) "Commercial loans" means any loan other than a loan to an individual for personal, family, household, or charitable purposes, and includes the purchase of retail installment loans or commercial paper, certificates of deposit, bankers' acceptances, and similar money market instruments, the extension of broker call loans, the sale of federal funds, and the deposit of interest-bearing funds.

49 Fed. Reg. at 818, *codified at* 12 C.F.R. § 225.2(a)(1).

The Board adopted broad definitions of the terms "demand deposits" and "commercial loans" in order to restrain the expansion of nonbank banks. The Board determined that these institutions were being acquired by nonbanking organizations and bank holding companies without compliance with the BHC Act's requirements. Although the Board did not go so far as to declare that nonbank banks were unlawful *per se*,[8] the Board sought to restrict the area in which nonbank banks could operate. Relying upon its authority under Section 5(b) of the BHC Act to "prevent evasions" of the Act, the Board determined that its definitions were essential to prevent nonbank banks from evading two fundamental purposes of the Act—*viz.*, (1) the prohibition against interstate acquisitions of deposit-taking banks without state permission, and (2) the separation of banking from nonbanking enterprises.[9]

2. The Decision Below

In holding invalid the Board's definitions of "demand deposits" and "commercial loans," the Tenth Circuit relied primarily upon the literal meaning and "general . . . industry usage" of these terms as used in Section 2(c) of the BHC Act.[10] The court concluded that Congress

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[8] As stated above, the Eleventh Circuit has recently held that nonbank banks *are* unlawful *per se* to the extent that they accept deposits and are established across state lines without state authorization pursuant to the Douglas Amendment. *Florida Dept. of Banking*, 760 F.2d at 1141-44.

[9] *See* Supplementary Information, Appendix A to Board Revision of Regulation Y ("Board Appendix A"), 49 Fed. Reg. at 833-42, App. 20a-61a.

[10] *Dimension*, 744 F.2d at 1404-07, App. 4a-9a. In holding invalid the Board's definition of "demand deposits," the court below relied entirely upon its earlier decision in *First Bancorporation v. Bd. of*

had not intended to give the terms of Section 2(c) any broader meaning and therefore rejected the Board's attempt to do so by regulation. Thus, the court's decision permits institutions chartered as banks and performing banking services to operate throughout the United States *without* compliance with the BHC Act, so long as they abstain either from accepting "demand deposits" or from making "commercial loans," as narrowly defined by the court.

The Tenth Circuit's decision is in error. By focusing only upon the literal meaning of the terms "demand deposits" and "commercial loans" in Section 2(c), the court overlooked the fundamental precept of statutory construction that a statute should *not* be interpreted in a manner which violates its essential purposes and therefore is "plainly at variance with the policy of the legislation as a whole." [11] The decision below utterly failed to consider the congressional purposes underlying the BHC Act, upon which the Board had expressly relied in adopting its regulation. The court did not even discuss the congressional policy of separation of banking from nonbanking enterprises. Moreover, the court specifically *refused* to consider the congressional mandate in the Douglas Amendment against interstate bank acquisitions without state authorization.[12]

The Tenth Circuit's decision is also contrary to another fundamental rule of statutory construction, *viz.*, that a statute should be construed in accordance with congressional intent as manifested in the legislative history.[13] The court completely misread the legislative history of the 1966 and 1970 amendments to Section 2(c) of the BHC Act, which defined "bank" in terms of the "demand deposit" and "commercial loan" tests.

Governors of Fed. Res. Sys., 728 F.2d 434 (10th Cir. 1984), *rev'g* 68 Fed. Res. Bull. 253 (1982).

[11] *United States v. American Trucking Ass'ns*, 310 U.S. 534, 543 (1940), *quoting Ozawa v. United States*, 260 U.S. 178, 194 (1922). *See also* 2A Sutherland, *Statutes and Statutory Construction*, § 46.07 (C. Sands 4th ed. 1973).

[12] *See* notes 23-27, *infra*, and accompanying text.

[13] *Train v. Colorado Pub. Int. Research Group*, 426 U.S. 1, 9-10 (1976); 2A Sutherland, *supra* note 11, at § 48.01 *et seq.*

The court focused upon the literal terms of the 1966 amendment while ignoring the clear intent of Congress to include within the term "bank" every institution which accepts deposits subject to the practical ability of the depositor to withdraw funds by check or other negotiable instrument. Similarly, the court's conclusion that the 1970 amendment was broadly intended to exempt all banks which do not make "commercial loans," as that term is generally understood in the financial industry, is totally inconsistent with the relevant legislative history. That history shows that the 1970 amendment was a technical amendment understood by both Congress and the Board to apply *only* to a *single institution* (the Boston Safe Deposit and Trust Company) or perhaps a very few similar entities.[14] Nothing in the legislative history even remotely suggests that Congress contemplated in 1970 that, more than a decade later, owners of nonbank banks could seize upon the 1970 amendment to justify their creation of a new hybrid banking institution operating across state lines without state authorization and often controlled by nonbanking organizations.

Finally, the court below erred in holding that Section 5(b) of the BHC Act did not authorize the Board to adopt its definition of "bank." Section 5(b) authorizes the Board not only to "carry out the purposes" of the BHC Act but also to "prevent evasions thereof." Having determined that nonbank banks were evading the purposes of the Act, the Board was not only authorized but required to take action to prevent such evasion.[15]

[14] *Florida Dept. of Banking*, 760 F.2d at 1140-42. *See* also notes 37-40, *infra*, and accompanying text.

[15] *Wilshire Oil Co. v. Bd. of Governors of Fed. Res. Sys.*, 668 F.2d 732, 738-39 (3d Cir. 1981), *cert. denied*, 457 U.S. 1132 (1982); *Florida Dept. of Banking*, 760 F.2d at 1143-44.

In view of the "substantial deference" to which the Board was entitled under the decisions of this Court,[16] the court below clearly erred in rejecting the Board's factual determinations as to the likely effect of the activities of nonbank banks and the manner in which the Board shold carry out is obligations under Section 5(b).[17]

ARGUMENT

I. THE DECISION BELOW IS CONTRARY TO THE PURPOSES AND LEGISLATIVE HISTORY OF THE BANK HOLDING COMPANY ACT

A. The Court Below Failed to Consider the Purposes of the BHC Act

This Court has repeatedly affirmed that a statute should not be interpreted in a manner which violates its basic purposes.[18] The court below therefore erred in striking down the Board's regulation, because its decision is contrary to the central purposes of the BHC Act upon which the Board expressly relied.

1. *The Purposes of the BHC Act*

Congress sought to accomplish three major purposes when it passed the BHC Act in 1956. First, in Section 3 of the BHC Act, Congress sought to prevent the concentration of banking resources within a particular area which could result if bank holding companies continued to have an "unrestricted ability" to acquire additional banks.[19] Second, in Section 4 of the BHC Act, Congress sought to restrain the "combination under single control of both banking and nonbanking enterprises, permitting departure from the principle that banking institutions should not engage in business wholly unrelated to banking."[20] To accomplish this purpose, Congress imposed strict limitations upon the ability of bank holding companies to engage in nonbanking activities.[21]

Finally, in the Douglas Amendment, adopted as Section 3(d) of the Act, Congress prohibited "the creation of interstate deposit-taking networks by bank holding companies without specific state authorization." *Florida Dept. of Banking*, 760 F.2d at 1141.[22] The Douglas

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[16] *E.g., Securities Industry Ass'n v. Bd. of Governors of Fed. Res. Sys.*, 104 S.Ct. 3003 (1948) ("*Schwab*") at 3009.

[17] *Mourning v. Family Publications Serv.*, 411 U.S. 356, 369-71 (1973).

[18] *E.g., American Trucking Ass'ns*, 310 U.S. at 543; *Perry v. Commerce Loan Co.*, 383 U.S. 392, 399-400 (1966).

[19] S. Rep. No. 1095, 84th Cong., 1st Sess. (1955), *reprinted in* [1956] U.S. Code Cong. & Ad. News 2482-83 (quoting testimony of Chairman W. M. Martin, Jr. of the Board).

[20] S. Rep. No. 1095, *supra* note 19, [1956] U.S. Code Cong. & Ad. News at 2483 (quoting testimony of Chairman W. M. Martin, Jr. of the Board).

[21] In adopting the BHC Act, Congress intended to break up interstate conglomerate bank holding companies such as Transamerica Corp. In 1956, Transamerica controlled banks in ten states as well as extensive insurance and manufacturing enterprises. *See* 102 Cong. Rec. 6755 (1956) (remarks of Senator Robertson); *id.* at 6858 (remarks of Senator Douglas); *id.* at 6935-36 (remarks of Senator Fulbright). The Senate specifically rejected a proposed amendment which would have permitted Transamerica and other bank holding companies to retain the nonbanking assets which they held in 1956. *Id.* at 6933-41.

[22] In adopting the Douglas Amendment, Congress was responding to the efforts of bank holding companies to avoid the branching restrictions of the McFadden Act by acquiring numerous banks both within and across state lines. *Northeast Bancorp, Inc. v. Bd. of Governors of Fed. Res. Sys.*, 53 U.S.L.W. 4699, 4702 (U.S. June 10, 1985). The McFadden Act, 12 U.S.C. § 36, prohibits national banks from branching across state lines and allows them to branch within their home state only to the extent permitted to state banks by state law.

Senator Douglas emphasized that his Amendment would apply the policy of the McFadden Act to bank holding companies and thereby prevent the formation of interstate deposit-taking networks such as those which had been created prior to 1956 by Transamerica (whose banks controlled a majority of the total bank deposits in Nevada and substantial deposits in several other states) and by First Bank Stock Corp. and Northwest Bancorporation (which together controlled 55 percent of the total bank deposits in Minnesota, 44 per-

Amendment bars any bank holding company located in one state from acquiring a bank in another state without the specific statutory authorization of the latter state, and thereby ensures that each state can "retain local, community-based control over banking." *Northeast Bancorp,* 53 U.S.L.W. at 4702-03.

2. *The Tenth Circuit's Failure to Apply the Purposes of the BHC Act*

The court below failed to consider the congressional purposes upon which the Board had expressly relied in adopting its regulation. The court's failure in this regard is astonishing in view of the Board's specific finding that the expansion of nonbank banks since 1980 threatened to "undermine the system of bank holding company regulation as a whole." [23]

In its notice of final rulemaking, the Board pointed out that nonbank banks were being operated by commercial organizations in contravention of the BHC Act's policy of separation between banking and nonbanking activities, and were also being acquired across state lines in violation of the Douglas Amendment's policy against interstate banking without state permission.[24] Accordingly,

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cent of those in Montana, and nearly one-third of those in North and South Dakota). 102 Cong. Rec. 6858-60 (1956).

[23] Board Appendix A, 49 Fed. Reg. at 835, App. 27a.

[24] *See id.*, 49 Fed. Reg. at 833-36, App. 20a-31a.

The Board's regulation was particularly aimed at acquisitions of nonbank banks such as those proposed by The Dreyfus Corporation and Dimension Financial Corporation. Dreyfus, a nonbanking organization engaged in the underwriting and sale of securities, sought to acquire nonbank banks in both New Jersey and New York. *See* letters dated Dec. 10 and Dec. 16, 1982, from W. Wiles, Secretary of the Board, to W. Isaac, Chairman of the Federal Deposit Ins. Corp. ("FDIC") and J. Diamond, counsel to Dreyfus, Rec. 1014D and 1014F ("Dreyfus Letters"). Dimension, a nonbank holding company affiliated with a thrift institution, proposed to establish 31 chartered national banks in 25 states, to be operated as nonbank banks. *See* Decision of the Comptroller of the Currency, dated May 9, 1984, on Applications of Dimension to Charter 31 National Banks in

the Board concluded that its adoption of broadened definitions of "demand deposits" and "commercial loans" was necessary to prevent nonbank banks from evading the basic purposes of the BHC Act.[25]

The Tenth Circuit, however, did not even discuss the Act's policy of separating banking from nonbanking enterprises. Moreover, the court expressly *refused* to consider the Douglas Amendment's purpose of prohibiting interstate deposit-taking networks without state approval, even though it recognized that the Douglas Amendment "is a significant factor in the mix of state and federal regulation." 744 F.2d at 1410, App. 17a-18a.

The Tenth Circuit instead focused upon the literal terms of Section 2(c)'s reference to "demand deposits," and looked to "general . . . industry usage" in determining the meaning of "commercial loans." [26] However, this Court has held that the literal or general meaning of terms used in a statute should *not* be applied where, as in this case, such an approach would lead to a result "plainly at variance with the policy of the legislation as a whole." [27] In contrast to the Tenth Circuit's mecha-

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25 States, *reprinted in* 3 Quarterly Journal of the Office of the Comptroller of the Currency, No. 3, at 68, 69.

According to the Board's staff, nonbanking organizations currently own, or propose to acquire, 70 FDIC-insured nonbank banks and 30 uninsured nonbank banks. 1985 Board Staff Analysis submitted to House Committee on Banking, Finance and Urban Affairs, *reprinted in* "Nonbank Banks—Another List," 4 Bank. Expansion Rep. No. 12, at 12-18.

[25] Board Appendix A, 49 Fed. Reg. at 835-36, App. 27a.

[26] 728 F.2d at 436, 744 F.2d at 1403-07. Despite its stated reliance upon "industry usage," the Tenth Circuit ignored the fact that the American Bankers Association and the Independent Bankers Association of America, two of the largest bank trade associations, *supported* the Board's definition of "commercial loans" and did *not* challenge the Board's definition as being contrary to "industry usage." *See* Board Appendix A, 49 Fed. Reg. at 834, App. 21a.

[27] *American Trucking Ass'ns*, 310 U.S. at 543. *See also Wilshire Oil Co.*, 668 F.2d at 735-36; *Florida Dept. of Banking*, 760 F.2d at 1138-39.

nistic approach, this Court has made it clear that the "legislative intent" and "policy" of Congress are the critical factors in determining whether the Board's regulations are consistent with its statutory mandate.[28]

B. The Court Below Misperceived the Legislative Intent of the 1966 and 1970 Amendments to the BHC Act

The decision of the court below is also contrary to the rule of statutory construction requiring that a statute be construed in accordance with congressional intent as manifested in the relevant legislative history.[29] In fact, the Tenth Circuit completely misread the legislative intent of the 1966 and 1970 amendments to the definition of "bank" in Section 2(c) of the BHC Act.

1. *The Legislative History of the 1966 and 1970 Amendments Demonstrates that Congress Did Not Intend to Authorize a Broad Class of Nonbank Banks Which Could Be Operated in Contravention of the BHC Act's Purposes*

When it passed the BHC Act in 1956, Congress intended that each holding company which acquired two or more institutions *chartered as banks* would be subject to regulation under the Act. Section 2(c) of the 1956 Act defined "bank" to include "any national banking association or state bank, savings bank, or trust company." [30]

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[28] *Schwab,* 104 S. Ct. at 3009 and n.16.

[29] *Train,* 426 U.S. at 9-10; 2A Sutherland, *supra* note 11, at § 48.01 *et seq.* In contrast to the Tenth Circuit's emphasis on literal interpretation, this Court has held that the literal terms of a statute are conclusive as to its meaning *only* where there is *no* legislative history to indicate the meaning which Congress actually intended. *Compare Train,* 426 U.S. at 9-10, *with Sedima, S.P.R.L. v. Imrex Co.,* 53 U.S.L.W. 5034, 5038 n.13 (U.S. July 1, 1985). In this case, as shown below, there is abundant legislative history which contradicts the Tenth Circuit's literal interpretation of Section 2(c) of the BHC Act.

[30] Act of May 9, 1956, c. 240, § 2(c), 70 Stat. 133. *See* S. Rep. No. 1095, *supra* note 19, [1956] U.S. Code Cong. & Ad. News at 2486, 2489.

The primary purpose of the 1966 amendment to the BHC Act was to extend the scope of the Act and the Board's jurisdiction thereunder. Congress did so by repealing the 1956 Act's exemptions for regulated investment companies, long term trusts, and charitable organizations.[31]

In the 1966 amendment, Congress also modified the definition of "bank" in Section 2(c) to include "any institution that accepts deposits that the depositor has a legal right to withdraw upon demand . . . ." [32] A functional demand deposit test was thereby substituted for the original charter test, in order to exclude non-deposit trust companies, savings banks and industrial banks which did not offer deposit accounts subject to withdrawal on demand by check.[33] As explained by the Senate Banking Committee, the 1966 amendment was intended to include within the scope of the BHC Act every institution which "accepts deposits payable on demand (*checking accounts*), the commonly accepted test of whether an institution is a commercial bank." [34]

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[31] S. Rep. No. 1179, 89th Cong., 2d Sess. (1966), *reprinted in* [1966] U.S. Code Cong. & Ad. News 2385 at 2386-89. The repeal of these exemptions brought the Alfred I. DuPont trust (which controlled 30 banks in Florida) and Financial General Corp. (an investment company which controlled 21 banks in 5 states and the District of Columbia) within the scope of the Act. *Id.* at 2387-89.

[32] Act of July 1, 1966, Pub. L. No. 89-485, § 3, 80 Stat. 235, 236.

[33] Savings banks and industrial banks did not have authority in 1966 to accept deposits subject to withdrawal by check. This authority was not generally given to such institutions until they were authorized in 1980 to accept negotiable order of withdrawal ("NOW") accounts. *See* S. Rep. No. 368, 96th Cong., 1st Sess. 2, 5-7 (1979), *reprinted in* [1980] U.S. Code Cong. & Ad. News 236, 238, 240-42. *See also* notes 47-48, *infra,* and accompanying text.

[34] S. Rep. No. 1179, *supra* note 31, [1966] U.S. Code Cong. & Ad. News at 2391 (emphasis added). *See also* 112 Cong. Rec. 12385 (1966) (remarks of Senator Robertson) (1966 amendment would include institutions which "accept demand deposits subject to check").

The 1970 amendment to the BHC Act further expanded the coverage of the Act, by bringing one-bank holding companies within its scope. Congress took this step in response to two developments which had occurred since 1966. First, the nation's six largest banks had organized one-bank holding companies which combined the business of banking with various nonbanking activities which were not permitted under Section 4 of the BHC Act. Second, large nonbanking organizations were acquiring single banks. Congress therefore decided to regulate one-bank holding companies under the BHC Act in order to maintain its "long-standing policy of separating banking from commerce." [35]

As part of the 1970 amendment, Congress again modified the definition of "bank" in Section 2(c). The 1970 amendment retained the 1966 amendment's definition of "bank" as any institution which "accepts deposits that the depositor has a legal right to withdraw on demand", while adding a new provision that such an institution "engages in the business of making commercial loans." [36]

The legislative history reveals that both the Board and Congress understood the 1970 amendment to Section 2(c) to be a technical provision of extremely limited application. The amendment was introduced on the floor of the Senate, without explanation, by Senator Brooke of Massachusetts.[37] However, the pertinent legislative history indicates that there was *only one* banking institution, the Boston Safe Deposit and Trust Company ("Boston Safe"), which was known by Congress to have been exempted from the BHC Act under the amended definition. Governor Robertson of the Board advised the Senate Banking and Commerce Committee that the amendment "would have very limited application at present, possibly affecting only one institution." [38] Similarly, Representative Gonzalez, a member of the House Banking and Currency Committee, identified Boston Safe as "[v]irtually the only bank which does no commercial lending." [39] Thus, the legislative record is devoid of any indication that Congress intended to authorize a broad class of "nonbank banks" which could be operated by holding companies without regard to the requirements of the BHC Act.

In *Florida Dept. of Banking*, the Eleventh Circuit reviewed the legislative history of the 1970 amendment and concluded that the amendment was narrowly intended to exempt Boston Safe, "a single intrastate institution—or perhaps the very few entities similarly situated—which could be excluded from regulation under the Act without giving rise to the kind of abuses which the Douglas amendment was designed to prevent." 760 F.2d at 1142. The Court viewed the 1970 amendment as "a bit of local favoritism on the part of Senator Brook[e] of Massachusetts" which was intended "to exempt a valued local institution without affecting other commercial banks." *Id.* at 1140 n.10.

Moreover, the House conferees on the 1970 amendment agreed to the modified definition of "bank" only after instructing the Board to construe the exemption for banks not making commercial loans "as narrowly as possible in order that all bank holding companies which should be covered under the Act in order to protect the

[35] S. Rep. No. 1084, 91st Cong., 2d Sess. (1970), *reprinted in* [1970] U.S. Code Cong. & Ad. News 5519, 5520-22. *See also* 116 Cong. Rec. 14818-19 (1970) (remarks of Senator Brooke).

[36] Act of Dec. 31, 1970, Pub. L. No. 91-607, § 101(c), 84 Stat. 1760, 1761.

[37] 116 Cong. Rec. 14818-21 (1970) (remarks of Senator Brooke).

[38] *One-Bank Holding Company Legislation of 1970: Hearings on S. 1052, et al., before the Senate Committee on Banking and Currency*, 91st Cong., 2d Sess. 136-37 (1970).

[39] 116 Cong. Rec. 25848 (1970) (quoting from the *National Journal* of July 18, 1970). Representative Gonzalez also advised the House that "[t]he effect of the amendment is to exempt the Boston Co. [the parent holding company of Boston Safe] from the bill." *Id.* Significantly, Representative Gonzalez did *not* identify any *other* holding companies which would be exempted.

public interest will, in fact, be covered." [40] Thus, there is not a shred of evidence in the legislative record to indicate that the literal terms of the narrow 1970 amendment should be construed to repeal the long-standing congressional policies requiring the separation of banking from commerce and preventing the creation of interstate deposit-taking networks without state permission. Congress neither intended nor contemplated that the 1970 amendment could be used by owners of nonbank banks to effect a sweeping revolution in bank structure and regulation.

2. *The Tenth Circuit Misinterpreted the Relevant Legislative History*

When the decision of the court below is compared against the applicable legislative history, it is clear that the court completely misconstrued the intent of the 1966 and 1970 amendments to Section 2(c). First, the court focused only on the literal terms of the 1966 amendment. It therefore seized upon the alleged fact that NOW account holders do not have a "*legal right* of withdrawal on demand" to justify its conclusion that NOW accounts are not "demand" deposits.[41]

The Tenth Circuit, however, overlooked the intent of Congress in 1966 to treat *checking accounts* as the "commonly accepted test," and therefore the most important

[40] Conf. Rep. No. 1747, 91st Cong., 2d Sess. (1970), *reprinted in* [1970] U.S. Code Cong. & Ad. News 5561, 5573-74 (statement of House conferees). Although certain Senate conferees objected to the statement of the House conferees, their objections were *not* directed to the House conferees' instruction to the Board concerning the Section 2(c) "exemption." *See* 116 Cong. Rec. 42422, 42432-33 (remarks of Senators Sparkman and Bennett).

The statements of the House conferees, the Board, and Representative Gonzalez should be given decisive weight where, as here, the 1970 amendment's proponent (Senator Brooke) was completely silent and did not attempt to refute the statements by other members of Congress. *Arizona v. California*, 373 U.S. 546, 583 n.85 (1963).

[41] *See First Bancorporation*, 728 F.2d at 435 (emphasis added); *Dimension*, 744 F.2d at 1404, 1411, App. 4a, 18a.

indicia, of whether an institution should be regulated as a "bank" under the BHC Act.[42] The Third Circuit Court of Appeals, in contrast to the Tenth Circuit, has held that Congress' emphasis upon checking accounts indicates that Congress was concerned with the ability of depositors "*in practice* to withdraw [their deposits] on demand." [43]

The Tenth Circuit itself acknowledged that withdrawals from NOW accounts "are in practice permitted on demand." The court also recognized that depositors can withdraw funds from NOW accounts by means of negotiable instruments. *First Bancorporation*, 728 F.2d at 435-36. Thus, the court's own findings reveal that NOW accounts *do* have the features upon which Congress focused in the 1966 amendment—namely, the practical ability of the depositor to withdraw funds on demand by means of a negotiable instrument such as a check.[44]

The Tenth Circuit also misread the legislative history of the 1970 amendment to Section 2(c). While acknowledging that Boston Safe was the only "example" given to Congress of the type of bank which would be exempted by the 1970 amendment, the Tenth Circuit nonetheless stated that "[t]he Act itself with the clearly expressed definitions permitted the development of the non-bank banks." 744 F.2d at 1407, App. 9a. The court admitted that Congress had been advised that the 1970 amendment would have a "limited impact," but dismissed this fact by saying that such advice was merely a "pre-

[42] *See* note 34, *supra*, and notes 46-48, *infra*, and accompanying text.

[43] *Wilshire Oil Co.*, 668 F.2d at 737 (emphasis in original).

[44] Indeed, the Court's rigid insistence upon the depositor's "legal right" to withdraw funds on demand would prevent even conventional checking accounts from being treated as "demand deposits," since there are certain situations (*e.g.*, the insolvency of the bank) in which the holders of such accounts would *not* have a "legal right" to withdraw funds on demand. *See, e.g.*, 12 U.S.C. §§ 197a, 206, 1821(f).

diction" which proved to be incorrect. Accordingly, the court held that nonbank banks could not be considered as "evasions" of the BHC Act. *Id.*

Contrary to the Tenth Circuit's position, it is clear that Congress intended the 1970 amendment to be a technical provision of extremely limited application which would exempt *only* Boston Safe and perhaps a few similar intrastate institutions. The House conferees specifically instructed the Board to construe the exemption "as narrowly as possible," an instruction which the court below ignored.[45] The court also failed to consider the adverse impact which *its* interpretation of the 1970 amendment would have upon the congressional policies requiring the separation of banking from commerce and prohibiting the acquisition of deposit-taking banks across state lines without state permission. Finally, the court's broad interpretation of the 1970 amendment is contradicted by the much narrower construction of the Eleventh Circuit in *Florida Dept. of Banking,* which is fully consistent with the legislative history.

C. The Board Correctly Applied the Intent and Purposes of the BHC Act in Adopting Its Definition of "Bank" in Regulation Y

The Board correctly analyzed the purposes of the BHC Act, as well as the relevant legislative history, when it adopted its definition of "bank" in Regulation Y. First, the Board defined "demand deposits" to accomplish the same goal that Congress intended in adopting its 1966 amendment—namely, to ensure that all banking institutions which accept checking accounts or similar transaction accounts will be regulated as "banks" under the BHC Act. The Board determined that NOW accounts and other "transaction accounts" (all of which did not exist in 1966) are in practice payable on demand and therefore are the functional equivalents of checking accounts. The Board therefore concluded that there would be a serious potential for evasion of the BHC Act unless institutions

[45] *See* notes 37-40, *supra*, and accompanying text.

offering transaction accounts and extending commercial credit were brought within the definition of "bank." [46]

The Board's inclusion of transaction accounts within its definition of "demand deposits" is consistent with congressional intent as manifested in the 1966 amendment to Section 2(c). As the Third Circuit pointed out in *Wilshire Oil*, 668 F.2d at 736-37, the 1966 amendment focused upon checking accounts, which were payable in practice upon demand, as the "commonly accepted test" of banking. *Accord, Florida Dept. of Banking*, 760 F.2d at 1139, 1142. In light of the intent of the 1966 amendment, it is significant that, when Congress authorized NOW accounts in 1980, it viewed such accounts as being "in effect . . . interest bearing checking accounts." [47] Indeed, Congress provided that bank reserves would be required with respect to such accounts (as well as other transaction accounts) to the same extent as reserves are required for conventional demand checking deposits.[48]

[46] Board Appendix A, 49 Fed. Reg. at 836-39, App. 32a-45a. *See also First Bancorporation,* 68 Fed. Res. Bull. at 253-54.

[47] S. Rep. No. 368, *supra* note 33, at 7, [1980] U.S. Code Cong. & Ad. News at 242-43.

[48] Depository Institutions Deregulation and Monetary Control Act of 1980, Pub. L. No. 96-221, §§ 103 (*amending* 12 U.S.C. § 461(b) (1) (C) and (2)) and 303 (*amending* 12 U.S.C. § 1832(a)), 94 Stat. 132, 133-34 and 146. In contrast to transaction accounts, *different* levels of reserves are required for "nonpersonal time deposits" and *no* reserves are required for personal savings accounts. *See id.* at § 103.

Congress did exempt NOW accounts from the prohibition in 12 U.S.C. §§ 371a, 1828(g) and 1832(a) against the payment of interest on demand deposit accounts. However, the exemption of NOW accounts from treatment as demand deposits was *only* for the purposes of this prohibition, and Congress otherwise believed that such accounts *were* demand deposits. S. Rep. No. 368, *supra* note 33, at 2, 5-7, 20, [1980] U.S. Code Cong. & Ad. News at 238, 240-43 and 256. It is significant that Congress did *not* exempt NOW accounts from treatment as demand deposits either for purposes of the reserve requirements under 12 U.S.C. § 461(b) *or* for purposes of Section 2(c) of the BHC Act.

Second, the Board correctly recognized the very limited scope of the exemption to Section 2(c) created by the 1970 amendment. The Board's broad definition of "commercial loans" is consistent with the specific instruction of the House conferees that the exemption be construed "as narrowly as possible" to prevent evasions of the Act.[49] Indeed, because a primary objective of Congress in adopting the BHC Act in 1956, and amending it in 1966 and 1970, was to control companies which use deposits to provide commercial credit, the Board's definition properly covers all types of transactions, including money market transactions, in which credit is extended for a business purpose.[50]

The Board's decision to adopt the broadest possible definition of "commercial loans" was based upon its finding that, since 1980, the policies of the BHC Act had been undermined by various banking and nonbanking organizations which were establishing nonbank banks to exploit a purported "loophole" in the Act, based upon a literal reading of Section 2(c).[51] In this environment, the Board reasonably determined that changed circumstances since 1980 required it to adopt a definition of "commercial loans" which would prevent continued evasions of the policies of the BHC Act.[52]

Indeed, the Board's definition of "commercial loans" did not represent a radical departure from its earlier interpretations of the 1970 amendment to Section 2(c). In those earlier decisions, the Board expressly stated that the term "commercial loans" included all loans other

[49] Board Appendix A, 49 Fed. Reg. at 834, 839, App. 23a-24a, 47a. *See also* the Dreyfus Letters, *supra* note 24.

[50] The Board specifically found that nonbank banks could use money market transactions, such as the purchase of certificates of deposit and bankers' acceptances and the sale of federal funds, as effective substitutes for other types of commercial loans. Board Appendix A, 49 Fed. Reg. at 834-36, 839-42, App. 22a-31a, 45a-61a.

[51] *See* notes 23-25, *supra*, and accompanying text.

[52] Board Appendix A, 49 Fed. Reg. at 834-36 App. 22a-31a.

than those made to an individual for personal, household, or charitable purposes. The Board also made clear that its decision to permit a few institutions to engage in money market transactions, without being deemed to have made commercial loans, was limited to the special facts of those institutions and was subject to change.[53] Thus, the financial industry had been on notice since the early 1970's that the Board might adopt a broad definition of "commercial loans" which would embrace money market transactions. Even if the Board's action could be considered a substantive departure from its earlier decisions, this Court has upheld the discretionary authority of a regulatory agency to modify its position in response to changed conditions.[54]

In sum, the Board's definitions of "demand deposits" and "commercial loans" are consistent with the purposes and intent of the BHC Act, and represent a rational response to the threat posed by the proliferation of nonbank banks.[55] Therefore, the Board's definitions should be upheld.

[53] *See, e.g.*, Letter dated May 18, 1972, from the Board to L. J. Aubrey of the Federal Reserve Bank of Boston regarding Boston Safe Deposit and Trust Co., Rec. 1041R; Letter dated May 28, 1981 from the Board to R. S. Miller, Jr., of Chrysler Corp., *reprinted in* [1981-82] Fed. Bank. L. Rep. ¶ 98,770.

[54] In *American Trucking Ass'ns v. Atchison, Topeka & Santa Fe Railway*, 387 U.S. 397, 416 (1967), this Court said:

> Regulatory agencies do not establish rules of conduct to last forever; they are supposed, within the limits of the law and fair and prudent administration, to adapt their rules and practices to the Nation's needs in a volatile, changing economy. They are neither required nor supposed to regulate the present and the future within the inflexible limits of yesterday.

Accord, Permian Basin Area Rate Cases, 390 U.S. 747, 784 (1968).

[55] It should be noted that the Board's Regulation Y, because of its general scope, does not address every possible evasion of the BHC Act by nonbank banks. For example, following the Board's adoption of Regulation Y, the Board reluctantly permitted a New York bank holding company to establish a deposit-taking nonbank bank (which agreed not to make any "commercial loans" as defined

II. THE TENTH CIRCUIT MISCONSTRUED THE AUTHORITY OF THE FEDERAL RESERVE BOARD UNDER SECTION 5(b) OF THE BANK HOLDING COMPANY ACT

In striking down Regulation Y, the Tenth Circuit completely misconstrued the scope of the Board's rulemaking authority under Section 5(b) of the BHC Act. The court's pronouncement (744 F.2d at 1408, App. 12a) that the "authority of the Board under the Act is to be exercised in a restricted area [and] [i]t does not have the broad scope to work in as do many other agencies" is utterly inconsistent with the explicit terms of Section 5(b) and the broad construction of the Board's authority by this Court and by other Courts of Appeal.

A. The Board Has Been Granted Broad Authority to Implement and Interpret Federal Banking Law Generally and the BHC Act in Particular

The Federal Reserve System is central to the functioning of our economic and monetary system.[56] In order to administer this system, the Board has been given broad statutory authority and administrative flexibility to carry out the purposes of Federal banking laws, which authority has been consistently recognized by this Court. As stated in *Securities Industry Association v. Bd. of Governors of Fed. Reserve Sys.*, 104 S.Ct. 2979 (1984)

in Regulation Y) in Florida, *without* Florida's authorization. *U.S. Trust Corp.*, 70 Fed. Res. Bull. 371 (1984). Within a short time thereafter, bank holding companies filed applications to establish hundreds of deposit-taking nonbank banks across state lines in reliance upon this alleged loophole left by Regulation Y.

The Eleventh Circuit, however, struck down the Board's *U.S. Trust* order in its decision in *Florida Dept. of Banking*. The Eleventh Circuit held that the Board should have denied U.S. Trust's application to acquire the Florida deposit-taking bank (even though it technically complied with Regulation Y), because the application violated the clear purpose of the Douglas Amendment. 760 F.2d at 1141-44.

[56] E. Symons, Jr. & J. White, *Banking Law* 48 (1984).

("*Bankers Trust*") at 2983: "The Board is the agency responsible for federal regulation of the national banking system. . . ."

Beyond its general authority to supervise the nation's financial and monetary system, the Board has been expressly charged by Congress with implementing the BHC Act and ensuring that its purposes are carried out. The scope of the Board's authority to carry out that responsibility is explicitly set forth in Section 5(b) of the BHC Act:

> The Board is authorized to issue such regulations and orders as may be necessary to enable it to administer and carry out the purposes of [the BHC Act] *and prevent evasions thereof.*

12 U.S.C. 1844(b) (emphasis added).

The broad delegation to the Board under Section 5(b) is in two parts. First, Congress empowered the Board to "issue such regulations and orders as may be necessary to enable it to administer and carry out the purposes of this chapter . . ." This language is consistent with the authority generally delegated to agencies under many acts. Second, Congress *specifically directed* the Board to use its regulatory authority to "*prevent evasions*" of the Act. Congress thus invested the Board with broad power to see that the purposes of the BHC Act are not frustrated.[57]

In *Mourning v. Family Publications Service*, 411 U.S. 356 (1973), this Court dealt with the Truth in Lending

[57] Although the Board is granted broad authority under Section 5(b), such authority is not without significant limits. The Board must exercise its powers under Section 5(b) within the scope of the purposes Congress sought to achieve as reflected by the relevant legislative history and other appropriate aids to construction. The Board may not create policies that are outside the purposes of the laws it administers. *See Bankers Trust*, 104 S. Ct. at 2983. In the instant case there is no question that the Board properly carried out the purposes of the BHC Act, and therefore the Board's regulation was within its statutory authority.

Act, 15 U.S.C. § 1064 ("TILA"), which, in language similar to Section 5(b), directed the Board to prevent evasions of the governing statute. The issue was whether the Board exceeded its authority under TILA in adopting a rule which provided that all consumer transactions involving more than four installments would be subject to credit disclosure requirements. In upholding the authority of the Board to issue the rule, this Court said:

> In addition to granting the Board the authority normally given to administrative agencies to promulgate regulations designed to "carry out the purposes of the Act," Congress specifically provided:
>
> > "These regulations may contain classifications, differentiations, or other provisions, and may provide for such adjustments and exceptions for any class of transactions, as in the judgment of the Board are necessary or proper . . . *to prevent circumvention or evasion* [of TILA], or to facilitate compliance therewith."
>
> The Board was thereby empowered to define such classifications as were reasonably necessary to insure that the objectives of the Act were fulfilled, *no matter what adroit or unscrupulous practices were employed* by those extending credit to consumers. [411 U.S. at 361-62, 365-66 (emphasis added).]

In light of this Court's decision in *Mourning*, the Tenth Circuit was patently wrong in holding that "[t]he authority of the Board under the Act is to be exercised in a restricted area . . . limit[ed] . . . basically to anticompetitive considerations."[58] As discussed above, Congress authorized the Board under the BHC Act to deal with broad issues of geography, concentration of banking resources and the relationship of banking and commerce.[59] Congress clearly intended, and expressly provided in Section 5(b), that the Board would have broad authority

[58] *Dimension*, 744 F.2d at 1408, App. 12a.

[59] See Argument, Part I(A)(1), *supra*.

not only to implement the BHC Act but also to prevent, in the words of *Mourning*, "adroit and unscrupulous practices" from evading its purposes.[60]

The Third and Eleventh Circuit Courts of Appeal have recently dealt with the authority of the Board under Section 5(b) of the BHC Act. Each court determined, contrary to the Tenth Circuit, that the Board has broad authority to act where the purposes of the BHC Act are being evaded.

In *Wilshire Oil Co.*, the Third Circuit upheld a cease and desist order issued by the Board against Wilshire on the ground that its subsidiary, the Trust Company of New Jersey ("TCNJ"), was a "bank" whose ownership by a nonbanking entity such as Wilshire was prohibited under the BHC Act. Wilshire argued that TCNJ had reserved the right to require prior notice of withdrawals from its transaction accounts (although TCNJ stated that it did not intend to exercise such right), and therefore was not a "bank" because it did not accept "demand deposits." The Board rejected Wilshire's argument and ordered Wilshire to divest itself of TCNJ.

The Third Circuit held that the Board had properly exercised its power under Section 5(b) to prevent Wilshire's clear evasion of the BHC Act's purposes:

> Congress specifically instructed the Board to look at the purposes of the BHC Act in administering its terms. . . . *Congress enacted § 5(b) as a catch-all, to cover any other evasions attempted through activ-*

[60] The Senate committee report on the BHC Act as enacted in 1956 confirms that Congress intended to "centralize[] Federal administrative control under the [Act] in the Board," and that Section 5(b) would empower the Board "to issue appropriate regulations and orders in order to carry out the purposes of the [Act] and to prevent evasion of its provisions." S. Rep. No. 1095, *supra* note 19, [1956] U.S. Code Cong. & Ad. News at 2495-96.

ity conforming to the letter, but not the spirit, of the statute.

. . . .

Because we approve the Board's finding that the reservation of the right to advance notice served no banking purpose, but was made merely to withdraw TCNJ from the coverage of the BHC Act, we accept the Board's order as necessary to "prevent evasion" of the Act.[61]

Similarly, in *Florida Dept. of Banking*, the Eleventh Circuit held that the Board should have denied an application by a New York bank holding company to establish a deposit-taking nonbank bank in Florida without Florida's permission, because the application represented a clear evasion of the purpose of the Douglas Amendment:

We hold that *the Board should have used its power under § 5(b), 12 U.S.C. § 1844(b), to prevent evasion by U.S. Trust of the fundamental purposes of the Act.* . . . The Board is Congress' custodian of the Act. In that capacity, it is charged with insuring compliance with Congress' goals even when Congress muddies the waters.[62]

Thus, Section 5(b) charges the Board with the affirmative duty of preventing evasions of the BHC Act. Where, as here, the Board has determined that there is an evasion, it is not only empowered but compelled to halt such evasion in whatever form it may take, even though the proposed activity may conform to the literal language of the statute.[63]

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[61] 668 F.2d at 738 and n.13 (emphasis added).

[62] 760 F.2d at 1143-44 (emphasis added).

[63] While the revisions to Regulation Y are an appropriate response to attempts to circumvent the BHC Act, they do not address or resolve all the circumstances by which the Act may be evaded. Thus, to the extent that creative minds of businessmen and their lawyers devise schemes that, while technically conforming to the literal

As in *Wilshire*, the instant matter is of exceptional importance because the definition of "bank" in the BHC Act is key to the regulation of the banking industry. To eliminate by judicial edict the Board's flexibility to expand this definition would significantly impair the Board's ability to close unintended loopholes in the Act and in its own interpretations of the Act.

B. The Board's Definitions of Demand Deposits and Commercial Loans Were Within Its Authority Under Section 5(b) and Should Be Upheld

As already shown, the Board's definitions of "demand deposits" and "commercial loans" are well within the scope of its authority, especially when confronted with a situation presenting significant potential for undermining the purposes of a statute it is charged to administer. The court below asserted that by revising those definitions the Board had impermissibly expanded its jurisdiction. Such, however, was not the case. The Board was simply responding to its mandate under Section 5(b) to prevent serious evasions of the BHC Act.

Indeed, the Tenth Circuit recognized the problems with the definitions in Section 2(c), caused by rapidly developing conditions in the financial markets. 744 F.2d at 1407, 1410, App. 10a, 17a. Surely this recognition supports the Board's position as to the great potential for evasions of its jurisdiction by nonbank banks and the serious consequences of such evasions.

The Court below put great emphasis on the Board's earlier acquiescence in money market transactions that would be prohibited to nonbank banks under the Board's revised definition of "commercial loans." The Board determined, however, that money market activities engaged in on a small scale, and by a small number of institutions,

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language of the law, in effect evade its purposes, Section 5(b) clearly authorizes and requires the Board to prevent such evasions. *See Florida Dept. of Banking*, 760 F.2d at 1143-44.

did not have any significant impact on the Board's jurisdiction or subvert the purposes of the BHC Act. When, however, these actvities grew to the point where they *did* interfere with the duties of the Board and the purposes of the BHC Act, then Section 5(b) not only authorized but required the Board to respond to these changed circumstances by revising its regulation.[64]

Although the court below did not challenge the Board's determination that the unregulated growth of nonbank banks threatened to "undermine the system of bank holding company regulation as a whole," [65] the court expressed concern that the Board had made a "complete change" in its definitions. 744 F.2d at 1406, App. 9a. As already noted, however, the revisions to the regulation were not radically inconsistent with prior Board positions. Even if they were, the Board had the discretion to review and revise its interpretations in the light of changing circumstances.[66] This Court has in fact upheld a complete change in agency position where the agency amended its regulations to ensure compliance with the overall intent of the governing statute.[67]

Congress has invested the Board with preeminent authority to regulate bank holding companies and to carry

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[64] *See* notes 51-54, *supra,* and accompanying text. Respondents in *Mourning* argued, much as the Tenth Circuit held here, that because of specific enumerations contained in the statute the Board's rule-making authority was restricted. *See* 744 F.2d at 1408-09, App. 12a-15a. This Court rejected that argument, saying: "To accept respondent's argument would undermine the flexibility sought in vesting broad rule-making authority in an administrative agency." 411 U.S. at 372.

[65] Board Appendix A, 49 Fed. Reg. at 835, App. 27a.

[66] See notes 53-54, *supra,* and accompanying text.

[67] In *American Trucking Ass'ns v. United States,* 344 U.S. 298, 314 (1952), this Court said that "[t]he mere fact that a contrary position was taken," did not prevent an agency from subsequently promulgating a regulation.

out the purposes of the BHC Act.[68] The Board therefore has the requisite authority and expertise to promulgate rules which address the complex and changing nature of the banking industry while preventing evasions of the BHC Act.

This Court has often recognized the Board's broad authority and expertise,[69] and has accordingly held that "substantial deference" must be given to the Board "whenever its interpretation provides a reasonable construction of the statutory language and is consistent with legislative intent." [70] In this case, it is clear that the Board's definition of "bank" represents a reasonable interpretation of Section 2(c) and is faithful to the intent and purposes of the BHC Act. Therefore, the Board's regulation should be upheld.

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[68] Despite the Tenth Circuit's reliance upon the fact that the FDIC and the Comptroller of the Currency had disagreed with the Board's expanded definition of "commercial loans" (744 F.2d at 1406, 1408, 1410, App. 7a-8a, 12a-17a), the views of those agencies have *no* legal effect in this case. This Court has repeatedly held that the Board's authority to administer and interpret the BHC Act is "paramount" and overrides the views of any other federal banking agency. *Bd. of Governors of Fed. Res. Sys. v. First Lincolnwood Corp.,* 439 U.S. 234, 250 (1978); *Whitney Nat'l Bank v. Bank of New Orleans & Trust Co.,* 379 U.S. 411, 419-20 (1965).

[69] "Not only because Congress has committed the system's operation to their hands, but also because the system itself is a highly specialized and technical one, requiring expert and coordinated management in all its phases, I think their judgment should be conclusive upon any matter which, like this one, is open to reasonable difference of opinion. Their specialized experience gives them an advantage judges cannot possibly have, not only in dealing with the problems raised for their discretion by the system's working, but also in ascertaining the meaning Congress had in mind in prescribing the standards by which they should administer it." *Investment Co. Inst. v. Bd. of Governors of Fed. Res. Sys.,* 450 U.S. 46, 56-57 n.21 (1981), *quoting Bd. of Governors v. Agnew,* 329 U.S. 441, 450 (1946) (Rutledge, J., concurring). *See also Schwab,* 104 S. Ct. at 3009.

[70] *Schwab,* 104 S. Ct. at 3009.

CONCLUSION

For the reasons set forth above, the decision of the court below should be reversed.

Respectfully submitted,

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No. 84-1274

In the Supreme Court of the United States

OCTOBER TERM, 1985

BOARD OF GOVERNORS OF THE
FEDERAL RESERVE SYSTEM, PETITIONER

v.

DIMENSION FINANCIAL CORPORATION, ET AL.

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*ON WRIT OF CERTIORARI TO
THE UNITED STATES COURT OF APPEALS
FOR THE TENTH CIRCUIT*

**BRIEF FOR THE UNITED STATES AS
AMICUS CURIAE SUPPORTING AFFIRMANCE**

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QUESTION PRESENTED

The Bank Holding Company Act of 1956, 12 U.S.C. 1841 *et seq.*, permits the Federal Reserve Board to impose certain requirements on the acquisition, operation, and control of a subsidiary that "(1) accepts deposits that the depositor has a legal right to withdraw on demand, and (2) engages in the business of making commercial loans." 12 U.S.C. 1841(c). The question presented is whether the Federal Reserve Board may extend its regulatory authority to institutions that accept deposits subject to "negotiable orders of withdrawal" or that conduct transactions outside the sphere of traditional commercial lending, based on the Board's determination that regulation of these institutions would advance the purposes of the Act.

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ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE TENTH CIRCUIT

BRIEF FOR THE UNITED STATES AS AMICUS CURIAE SUPPORTING AFFIRMANCE

INTEREST OF THE UNITED STATES

The Bank Holding Company Act of 1956 (BHCA), 12 U.S.C. 1841 *et seq.*, regulates the activities of bank holding companies "to restrain undue concentration of commercial banking resources and to prevent possible abuses related to the control of commercial credit." S. Rep. 91-1084, 91st Cong. 2d Sess. 24 (1970). It permits the Board of Governors of the Federal Reserve System (the Federal Reserve Board) to impose certain requirements on companies that control a specific class of financial institutions that Congress has determined are of central importance to the Nation's commercial credit resources. Congress, through Section 2(c) of the BHCA, has carefully defined that class by two pertinent attributes, including within it any banking institution that "(1) accepts deposits that the depositor has a legal right to withdraw on demand, and (2) engages in the business of making commercial loans." 12 U.S.C. 1981(c). The definition thus encompasses traditional commercial banking institutions that provide conventional demand checking accounts and direct lending to business enterprises.

In 1984, the Federal Reserve Board amended Regulation Y, 12 C.F.R. 225.2(a)(1), to "clarify" the application of the BHCA (Pet. App. 20a-21a). Through these amendments, the Board attempted to extend the Act's reach by reinterpreting Section 2(c)'s definition of a "bank" to include not only conventional commercial banks that offer "demand" checking and engage in commercial lending, but also institutions (colloquially known as "non-bank banks" or NBBs) that, inter alia, offer "negotiated order of withdrawal" (NOW) accounts and conduct transactions outside the sphere of traditional commercial lending (Pet. App. 20a-61a). Numerous commentators, including the Federal Reserve Banks of San Francisco, Chicago, and Atlanta, the Comptroller of the Currency (the Comptroller) and the Federal Deposit Insurance Corporation (FDIC), objected to the Board's interpretation (see J.A. 22A-33A). It was pointed out that the Board's definition departed from the plain and accepted meaning of Section 2(c) (see J.A. 34A-38A, 39A-58A). The Board nevertheless maintained that "these interpretations are both necessary and appropriate to carry out the fundamental purposes of the Act" (Pet. App. 22a). The United States Court of Appeals for the Tenth Circuit disagreed. It has twice disapproved the Board's interpretation of Section 2(c), rejecting its "demand deposit" definition in *First Bancorporation* v. *Board of Governors*, 728 F.2d 434 (1984), and rejecting both its "demand deposit" and "commercial loan" definitions in the present case (Pet. App. 1a-19a). The Board now tests the propriety of its interpretation in this Court.

The questions raised by this case are of fundamental importance to the Nation's financial services community. They are of basic importance to the United States as well. Indeed, the Board's action intersects the United States' interests on three distinct planes, and at each intersection the Board's position is progressively more disquieting.

First, the Board's decision upsets the delicate balance that exists among government agencies charged with regulating financial institutions. The American financial services industry is perhaps the most diverse and complex in the world, consisting of a mix of approximately 50,000 institutions offering a wide range of consumer and commercial services. Recognizing the importance of financial institutions to economic growth and domestic stability, Congress has subjected them to an elaborate, decentralized financial regulatory scheme, requiring the interaction and cooperation of numerous federal and state agencies.[1] These agencies operate in dynamic equilibrium to promote the stability of both individual institutions and the system as a whole.[2]

The Federal Reserve Board's amendments to Regulation Y disturb the carefully considered balance that Congress has struck. They represent an attempt by the Board to expand its authority through a redefinition of those precise statutory terms that Congress chose to delimit the Board's regulatory power. The Board's unilateral action works a basic structural change in federal banking regulation that significantly expands its regulatory authority without regard to the effects on other federal and state banking agencies and other regula-

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[1] At the federal level alone, Congress has placed financial regulatory responsibility in seven primary agencies: the Federal Reserve Board, the Comptroller, and the FDIC for banks; the Federal Home Loan Bank Board (FHLBB) for thrift institutions; the National Credit Union Administration (NCUA) for credit unions; the Commodities Futures Trading Corporation (CFTC) for commodities and futures firms; and the Securities and Exchange Commission (SEC) for securities firms. See generally *Blueprint for Reform: The Report of the Task Group on Regulation of Financial Services* 8, 16 (July 1984), *reprinted in* Fed. Banking L. Rep. (CCH) No. 1050 (Nov. 16, 1984); House Comm. on Banking, Finance and Urban Affairs, 98th Cong., 1st Sess., *Formation and Powers of National Banking Associations—A Legal Primer* (Comm. Print No. 98-4, 1983) (hereinafter *National Banking Ass'ns*).

[2] For example, the Federal Reserve Board has primary responsibility with the state agencies for regulation of state-chartered member banks of the Federal Reserve System. But the Comptroller has primary responsibility for regulating national banks, including those that are subsidiaries of bank holding companies, and the FDIC shares regulatory responsibility with the states over state-chartered, federally-insured non-member banks. Additionally, Congress has consciously left many financial institutions, including mortgage companies, finance companies and insurance companies, subject primarily to the requirements of state law. This regulatory diversity reflects the Nation's historic preference for decentralized control over banking. See J. White, *Banking Law* 7 (1976).

tory regimes.[3] The United States maintains that Congress, rather than a single banking agency, has sole responsibility to make such far-reaching changes. The United States therefore responds to the Board's unusual action.

The United States' concerns do not rest solely with the Board's incursion upon other agencies' regulatory interests; more troubling is the manner by which the Board has accomplished that result. The Board has redefined statutory terms of plain meaning to expand its authority beyond what the language of its empowering statute permits. The United States agrees, of course, that a federal agency is entitled to substantial deference in its interpretation of a statute that it administers. However, the United States does not agree that a federal agency can employ unjustifiably expansive interpretive license to enlarge its regulatory powers, and then invoke the aegis of agency deference to deflect judicial disapproval. The United States believes that the traditional deference accorded a federal agency cannot supplant the Board's obligation to construe its empowering statute according to the unmistakably clear terms that Congress has employed.[4]

[3] Notably, NBBs are already extensively regulated by their chartering and insuring agencies. Thus, a federally chartered NBB is subject to all the laws, rules and regulations of the National Bank Act, 12 U.S.C. 1 *et seq.*, and the Federal Deposit Insurance Corporation Act, 12 U.S.C. 1811 *et seq.* A state-chartered federally-insured NBB is subject to regulation by its particular state and by the FDIC. Under these laws, NBBs are subject to the full supervisory and examination authority of their regulators. Transactions of an FDIC-insured NBB with its affiliates are carefully scrutinized by its primary federal regulatory under the Banking Affiliates Act of 1982, 12 U.S.C. 371c. The acquisition of a federally insured NBB by any individual or corporation is subject to the Change in Bank Control Act of 1978, 12 U.S.C. 1817(j), which requires the appropriate federal regulatory agency (the Comptroller, the FDIC, or the Board) to examine the same general financial, managerial, and competitive factors required under the BHCA. Thus, the issue in this case is not whether NBBs should be regulated, but rather the manner and scope of regulation.

[4] Because federal banking law is intricate and regulatory authority is dispersed among a number of adjacent agencies sharing a commonality of interests, each agency is under a prudential obligation to adhere closely to the terms of its empowering statutes. The complex regulatory scheme that Congress has devised requires each agency to act only within the sphere that Congress has specified. Indeed, Congress has presumably provided precise definitions of agency authority to prevent agencies from abusing their independence and overstepping their regulatory bounds.

Finally, the United States recognizes a third concern that transcends the questions of regulatory authority and agency deference. The Federal Reserve Board's action, expanding its regulatory authority through redefinition of plain statutory language, seriously undermines the legislative process. Congress must rely on statutory language to strike its compromises and state its intentions. Thus, the legislative process can function effectively only if the participants can expect that plain language will be applied by federal agencies according to its accepted meaning. Words, of course, can be imprecise; indeed, Congress may sometimes strike a compromise through imprecision. But it is one matter to recognize that Congress may delegate authority to the Executive Branch through the use of words of uncertain content; it is quite another to treat words as empty vessels into which an agency may pour whatever meaning it feels may comport with the broad "purposes" of the underlying statute. In the view of the United States, the Federal Reserve Board has engaged in the latter activity, ignoring the unusually precise language of the BHCA based on its view of present regulatory needs. The United States, sensitive to broader governmental interests, cannot discard the plain content of the terms Congress has chosen.[5]

Thus, the United States opposes the Federal Reserve Board's expansive redefinition of Section 2(c) of the BHCA and expresses its views through this brief amicus curiae.

INTRODUCTION AND SUMMARY OF ARGUMENT

The BHCA restrains undue concentration of commercial banking resources and abuses of commercial credit by

[5] Indeed, the Board's action is particularly troubling in light of the ongoing congressional debate concerning regulation of NBBs. Numerous bills concerning regulation of NBBs have received congressional attention in the last two legislative sessions. See, *e.g.*, H.R. 20, 99th Cong., 1st Sess. (1985) (reported to the full House June 18, 1985); S. 2851, 98th Cong. 2d Sess. (1984) (passed by the Senate Sept. 13, 1984). The Board's action, no doubt, will influence the outcome of that debate by changing the status quo during the course of legislative deliberations.

regulating the activities of bank holding companies. Congress, through its 1966 and 1970 amendments to Section 2(c) of the BHCA, expressly limited the Act's application to companies exercising control over commercial banks that accept "demand" deposits and engage in the business of making commercial loans. It excluded from the Act's definition of "bank" a variety of financial institutions, such as industrial banks, that do not offer commercial banking services. Since 1970, Congress has authorized the excluded institutions to offer new services, such as NOW accounts, that bear some similarity to demand deposits. Those institutions have also become more visible participants in money market and other investment transactions. In light of these changes, the Federal Reserve Board concluded that the excluded institutions should be treated as "banks" for purposes of the BHCA, despite Section 2(c)'s plain language excepting them from coverage. The Board asserted regulatory authority by amending Regulation Y broadly to redefine the operative terms of Section 2(c) and include the otherwise excluded institutions within the Act's reach. However as the court of appeals correctly held, those amendments cannot stand. They contradict the plain meaning of the statute, are inconsistent with the BHCA's legislative history, and usurp congressional power over fundamental questions of banking policy.

Section 2(c) of the BHCA first limits the term "bank," for purposes of the Act, to institutions that accept deposits "that the depositor has a legal right to withdraw on demand." 12 U.S.C. 1841(c). The court of appeals was correct in holding that the Board's redefinition of "demand deposit" to include NOW accounts is contrary to the plain language of the BHCA. Because institutions that offer NOW accounts must, by law, reserve the right to require advance notice prior to withdrawal—whether they choose to exercise the right or not—NOW account depositors do not have a "legal right" to withdraw those funds on demand. Contrary to the Board's suggestion, Section 2(c) does not extend the Board's authority to institutions that offer the "functional equivalent" of a demand deposit. But even if it did, a NOW account would not qualify. Although a NOW account bears some similarity, as a

practical matter, to a traditional checking account, it is instead a special species of savings account. Indeed, prior to 1982, the Board had ruled consistently that NOW accounts are not "demand deposits." It continues to treat NOW accounts as savings deposits in other regulations governing interest rates and reserve requirements. Thus, its contrary treatment of NOW accounts in the recent amendments to Regulation Y is a marked departure from its own position and the conventional understanding of the financial community.

The legislative history of the BHCA indicates that Section 2(c)'s demand deposit requirement was incorporated to exclude institutions that presently are authorized by Congress to offer NOW accounts. Congress chose its specific language, based on a "legal right to withdraw funds," to ensure that there would be no uncertainty concerning the reach of its exclusion. If Congress had intended that the Board should have wide-ranging authority to determine what institutions should now be covered by the BHCA, it would not have used such specific definitive language.

Section 2(c) of the BHCA further limits the term "bank" to only those "demand deposit" institutions that also "engage[] in the business of making commercial loans." 12 U.S.C. 1841(c). Congress used the term "making commercial loans," as it is commonly employed, to describe face-to-face loans from banks to business enterprises. The Board's regulations, defining "commercial loan" to include a broad range of passive investments, secondary market transactions, and interbank transfers, is contrary to the accepted meaning of the term. Indeed, the Board itself, until recently, had consistently refused to treat those transactions as "commercial loans." Nor can the Board's definition be squared with the purposes and legislative history of the Act. The BHCA was intended to protect against the use of commercial credit to advance anticompetitive practices between bank and the nonbank subsidiaries of bank holding companies. Face-to-face commercial lending, as conventionally understood, is susceptible to these types of abuses. However, the transactions included within the Board's definition, occurring largely in the secondary

money market, do not present the same potential for abusive practices. Indeed, the legislative history reveals that institutions that Congress clearly intended to exempt from the BHCA's coverage engaged in the transactions the Board now defines as commercial loans.

The Board ultimately defends its besieged effort to rewrite Section 2(c) by claiming that its judgment is entitled to judicial deference. But deference is inappropriate when an agency adopts a position plainly at variance with the statute it administers. The Board's claim to deference is further undermined by the fact that other federal banking agencies, equally involved and familiar with the intricacies of banking, disagree with the Board's interpretation of the BHCA. Nor can the Board's action be justified as necessary to prevent evasions of the Act. The Board's authority to police the boundaries of the Act does not empower it to redraw the borders that Congress has demarked. The Board's actions in the present case represent an unauthorized assumption of major policy decisions that are properly the province of Congress. Indeed, financial institutions that Congress had previously exempted from the Act would be swept back within its coverage.

Plainly, the financial services industry has undergone substantial changes since Congress formulated its definition of a "bank" for purposes of the BHCA. However, these changes are largely the result of Congress's deregulatory legislation, expanding the types of financial services that are available to the public. One can debate the proper scope of the BHCA in this new environment. But regardless of how one views that debate, it remains clear that Congress, rather than the Board, is the proper body to determine the reach of the Act.

ARGUMENT

FINANCIAL INSTITUTIONS THAT ACCEPT DEPOSITS SUBJECT TO A NEGOTIABLE ORDER OF WITHDRAWAL AND THAT CONDUCT TRANSACTIONS OUTSIDE THE SPHERE OF TRADITIONAL COMMERCIAL LENDING ARE NOT "BANKS" WITHIN THE MEANING OF SECTION 2(c) OF THE BANK HOLDING COMPANY ACT.

The BHCA subjects "any company which has control over any bank" (12 U.S.C. 1841(a)(1)) to extensive regulation. Thus, the definition of the term "bank" is central to the scope of the Act. Section 2(c) of the BHCA, as originally enacted, defined the term "bank" to include "any national banking association or any State bank, savings bank, or trust company." 12 U.S.C. (Supp. V 1953-1958) 1841(c); see Ch. 240, § 2(c), 70 Stat. 133. However, in 1966, Congress replaced the "charter" definition with a narrower test limited, in relevant part, to "any institution that accepts deposits that the depositor has a legal right to withdraw on demand." 12 U.S.C. (Supp. II 1965-1966) 1841(c); see Pub. L. No. 89-485, § 3, 80 Stat. 236. In 1970, Congress enlarged the Act's coverage to include one-bank holding companies but further narrowed the definition of "bank" to include only those domestic institutions that "accept[ ] deposits that the depositor has a legal right to withdraw on demand" *and* "engage[ ] in the business of making commercial loans." 12 U.S.C. 1841(c); see Pub. L. No. 91-607, § 101(c), 84 Stat. 1762.

In 1984, the Federal Reserve Board amended Regulation Y, governing application of the BHCA, to "clarify" the Act's definition of a "bank." See 49 Fed. Reg. 833 (1984) (see Pet. App. 20a-61a). Through these amendments, the Board responded to what it viewed as unwelcome changes in the financial services industry, including an expansion in the powers of industrial banks and the corporate acquisition of financial institutions offering limited depository and lending services (Pet. App. 24a-25a). The Board's amendments essentially redefined the statutory definition of a "bank" for purposes of the BHCA, providing (12 C.F.R. 225.2(a)(1)):

(A) "Deposits that a depositor has a legal right to withdraw on demand" (hereinafter "demand deposits") means any deposit with transactional capability that, as a matter of practice, is payable on demand and that is withdrawable by check, draft, negotiable order of withdrawal, or other similar instrument; and

(B) "Commercial loans" means any loan other than a loan to an individual for personal, family, household, or charitable purposes, and includes the purchase of retail installment loans or commercial paper, certificates of deposit, bankers' acceptances, and similar money market instruments, the extension of broker call loans, the sale of federal funds, and the deposit of interest-bearing funds.

This definition conflicts with the plain language and the legislative history of Section 2(c). It cannot be justified as an exercise of the Board's authority to administer the Act.

A. The Board's Expansive Redefinition of its Regulatory Authority is Inconsistent with the Plain Language and Legislative History of Section 2(c).

The Federal Reserve Board, like any federal agency, is bound by the terms of its empowering statute. Thus, the initial question in this case is whether Section 2(c) provides a conclusive definition of the term "bank." If the statutory definition provides a full expression of Congress's intent, "that is the end of the matter, for the court, as well as the agency, must give effect to the unambiguously expressed intent of Congress." *Chevron U.S.A. Inc.* v. *NRDC*, No. 82-1005 (June 25, 1984), slip op. 4. See, *e.g.*, *FEC* v. *Democratic Senatorial Campaign Comm.*, 454 U.S. 27, 31-32 (1981).

The principles for determining congressional intent are familiar. See, *e.g.*, *American Tobacco Co.* v. *Patterson*, 456 U.S. 63, 68 (1982). The "starting point must be the language used by Congress." *Reiter* v. *Sonotone Corp.*, 442 U.S. 330, 337 (1979). "Absent a clearly expressed legislative intention to the contary, that language must ordinarily be regarded as conclusive." *Consumer Product Safety Commission* v. *GTE Sylvania, Inc.*, 447 U.S. 102, 108 (1980). In examining that language, it must be assumed that " 'the legislative purpose is expressed by the ordinary meaning of the words used.' " *Russello* v. *United States*, 464 U.S. 16, 21 (1983), quoting *Richards* v. *United States*, 369 U.S. 1, 9, (1962). Thus, "unless otherwise defined, words will be interpreted as taking their ordinary, contemporary, common meaning." *Perrin* v. *United States*, 444 U.S. 37, 42 (1979).

In defining the term "bank" for purposes of the BHCA, Congress used precise words of accepted meaning that leave no room for administrative "clarification." The Board's regulations cannot be reconciled with the unambiguous import of those words. The legislative history does not support a contrary conclusion; indeed, it confirms that Congress held no intention that the Board should expand the carefully chosen statutory terms beyond their plain meaning.

1. Section 2(c) states, as the first element of its definition, that a "bank" must accept deposits that "a depositor has a legal right to withdraw on demand." 12 U.S.C. 1841(c). As Congress recognized and the Board concedes (Pet. Br. 28), this formulation is a precise legal description of a conventional "demand deposit" checking account. It does *not* describe a NOW account, which, by definition, gives the depositor *no legal right* to withdraw on demand.[6] Nor does it describe "any deposit with transactional capability that, *as a matter of practice*, is payable on demand." 12 C.F.R. 225.2(a)(1)(A) (emphasis added). A "legal right" simply cannot be equated with a custom or practice. Thus, the plain lan-

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[6] NOW accounts, like traditional savings accounts, are universally subject to a prior notice of withdrawal requirement and distinguished from "demand deposits" on that basis. See P. Heller, *Handbook of Federal Bank Holding Company Law* 6 n.21 (1976); *National Banking Ass'ns*, at 3-5; 12 C.F.R. 217.1(e), 217.135. See also, *e.g.*, Colo. Rev. Stat. § 11-22-108(a) (Supp. 1983); Fla. Stat. Ann. § 664.08(1) (West 1985); R.I. Gen. Laws §§ 19-20-9(a) and (b), 19-20-21 (1982). There is no merit to the Board's argument (Pet. Br. 31-32) that a NOW account depositor "does in fact have a legal right to withdraw funds" until the notice requirement is invoked. The same could be said of a savings account notice requirement, but the Board clearly recognizes that Congress intended to exclude from its definition "savings accounts which were in practice paid on demand" (*id.* at 29).

guage of Section 2(c) prohibits the Board's expansive redefinition of the term "bank."

The Board justifies its redefinition on the ground that a NOW account is the "functional equivalent" of a conventional checking account (Pet. Br. 26-27, 33). But Section 2(c) does not speak in terms of "functional equivalence." Instead, it defines a "bank" based on the depositor's "legal right to withdraw on demand." If Congress had intended that a "bank" should be defined according to "functional equivalence" it would have, at a minimum, incorporated into its statutory definition terms of sufficient generality to support the Board's expansive construction. Congress instead used precise language that, by its terms, includes conventional checking accounts but *excludes* what the Board describes as "functionally equivalent" depository accounts. Thus, the express language of Section 2(c) rebuts the Board's statement (Pet. Br. 27-28) that Congress "intended to create a functional test for delineating the kind of deposits covered by the Act."

In all events, the NOW accounts are not "functionally equivalent" to conventional checking accounts. A NOW account bears only one similarity to conventional checking—it permits the depositor to write negotiable drafts, payable to third parties, on the account. In all other respects it resembles a savings account. For example, NOW accounts bear interest, are not available to corporations operated for profit, and are subject to the institution's right to require notice prior to withdrawal. See 12 U.S.C. 1832; 12 C.F.R. 217.1(e), 217.135.[7] These characteristics support the

generally held commercial understanding that NOW accounts are a "special type of savings account. See *National Banking Ass'ns*, 3-5; see also P. Heller, *supra*, at 6 n.21.[8] Indeed, until recently, the Board itself wholeheartedly sub-

[7] The Board argues that the notice requirement "can never be practicably invoked with regard to NOW accounts," because of the potential "damage to the reputation of the institution and loss of customer good will" (Pet. Br. 32). It then speculates (*id.* at 32 n.32) that these disincentives do not exist with respect to passbook savings accounts. But both accounts are subject to the *same* notice requirements. See 12 C.F.R. 217.5(a) and 329.5(a). Invocation of the notice requirement, effectively freezing withdrawals, will impair customer goodwill regardless of whether depositors or third party payees are affected. Thus, the Board's suggestion that institutions would be more inclined to invoke the notice requirement with respect to traditional savings accounts than NOW accounts appears doubtful. Indeed, under the Board's regulations, an institution cannot elect to invoke its right to notice on passbook withdrawals but withhold that requirement on NOW account withdrawals. See *ibid.* Since most institutions offer both forms of savings accounts, it is misleading to suggest that exercise of the notice requirement is practicable with respect to one account but not the other. In any event, the validity of the right to demand notice is not diminished simply because the right is rarely invoked and only serious circumstances will lead to its exercise.

[8] NOW accounts have evolved as a variation of the traditional savings account. State regulated savings banks in New England initiated the NOW concept in the early 1970s by permitting savings account depositors to make third party withdrawals from their accounts. See Kaplan, *Federal Legislative and Regulatory Treatment of NOW Accounts*, 91 Bank. L. J. 439 (1974). In 1973, Congress authorized NOW accounts, on a trial basis, in those states, while limiting their use elsewhere. Pub. L. No. 93-100, § 2, 87 Stat. 342. In 1980, Congress authorized their introduction on a nationwide basis. See Depository Institutions Deregulation and Monetary Control Act, Pub. L. No. 96-221, § 303, 94 Stat. 146. Although Congress clearly recognized that NOW drafts could be used in place of checks (see S. Rep. 96-368, 96th Cong., 1st Sess. 5 (1979), it was also mindful of the differences between NOW accounts and traditional checking accounts, noting that "[u]nder the definition of a NOW account, a depository institution may require a depositor to give 30 days notice before withdrawal from a NOW account is made, similar to the notice requirement on any savings account, although such notice may not be required in practice" (*id.* at 7). See also *id.* at 8-9 (describing NOW accounts and credit union share draft accounts as "savings-type accounts [accessible] through draft instruments"). Indeed, the Board itself had testified that "NOW account[s] * * * can be regarded as a form of savings account." *The Consumer Checking Account Equity Act of 1979: Hearings on H.R. 3864 Before the Subcomm. on Financial Institutions Supervision, Regulation and Insurance of the House Comm. on Banking, Finance and Urban Affairs*, 96th Cong., 1st Sess. 88 (1979) (statement of Hon. Charles Partee, member, Board of Governors, Federal Reserve System). Commentators and courts have consistently recognized that a NOW account is a hybrid species of savings account rather than a checking account. See P. Heller, *supra*, at 6 n.21; Kaplan, *supra*, at 444-445; Comment, *The Negotiable Order of Withdrawal (NOW) Account: "Checking Accounts for Savings Banks?,"* B.C. Indus. & Com. L. Rev. 471, 486-487 (1973); *Pennsylvania Bankers Ass'n* v. *Secretary of Banking*, 481 Pa. 332, 337-338, 392 A.2d 1319, 1321-1322 (1978).

scribed to that understanding. It repeatedly held that institutions such as guaranty savings banks, which offer NOW accounts, "are not banks within the meaning of the [BHCA] since they do not accept demand deposits and engage in the business of making commercial loans." *First Financial Group of New Hampshire, Inc.* 66 Fed. Res. Bull. 594 (1980); see *Heritage Banks, Inc.*, 66 Fed. Res. Bull. 917 (1980); *Heritage Banks, Inc.*, 66 Fed. Res. Bull. 590 (1980). See also *D. H. Baldwin Co.*, 63 Fed. Res. Bull. 280, 286 (1977) (noting that savings and loan associations which offer NOW accounts, are not "banks" within the meaning of the BHCA). Its recent amendments to Regulation Y reverse a consistent twelve-year practice of regulating NOW accounts as savings deposits, a practice that remains in effect under other provisions of the Board's regulatory program.[9]

Thus, the plain language of the BHCA, reinforced by commercial understanding and the Board's own past practices, demonstrates that NOW accounts are not deposits that "a depositor has a legal right to withdraw on demand." While "it is not necessary to look beyond the words of the statute," *TVA* v. *Hill*, 437 U.S. 153, 184 n.29 (1978), the legislative history of Section 2(c) provides still further confirmation that the Board's interpretation is erroneous and manifestly contrary to congressional intent.

[9] Upon passage of Pub. L. 93-100, *supra*, the Board "propose[d] to treat the NOW account as a form of savings deposit." See 38 Fed. Reg. 26468 (1973). The Board, together with the FDIC and the FHLBB, subsequently issued regulations specifically categorizing NOW accounts as savings deposits rather than demand deposits, recognizing that the notice of withdrawal requirement distinguishes a NOW account from a demand deposit account. 38 Fed. Reg. 34457-34459 (1973). The Board has adhered to this distinction from 1973 to the present in Regulation Q, regulating interest rates, and Regulation D, regulating reserve requirements. For example, Regulation Q defines a "demand deposit" as "every deposit that is not a 'time deposit,' 'international banking facility time deposit,' or 'savings deposit,' as defined in this section." 12 C.F.R. 217.1(a). It then defines a "savings deposit" as including "[d]eposits subject to negotiable orders of withdrawal." See 12 C.F.R. 217.1(e)(3)(1). Regulation D establishes analogous definitions. See 12 C.F.R. 204.2(b)(1) and (d)(1)(i)(A). The Board's 1984 revision of Regulation Y, treating NOW accounts as demand deposit accounts, stands in marked departure from Regulations Q and D.

The legislative history reveals that Congress refined Section 2(c)'s definition of "bank" to ensure that industrial banks and similar institutions would be excluded from the Act. The original version of Section 2(c) defined "bank" to include "any national banking association or any State bank, savings bank, or trust company." 12 U.S.C. (Supp. V 1953-1958) 1841(c). But Congress intended the definition to include "commercial banks only." 102 Cong. Rec. 6957 (1956). The Board nonetheless construed the statutory definition to include industrial banks, despite its own acknowledgment that the BHCA's legislative history "indicated that the Act was directed principally at control of 'commercial' banks," and that industrial banks were generally "not regarded as being engaged in commercial banking." *Applicability of the Bank Holding Co. Act to Industrial Banks*, 49 Fed. Res. Bull. 165, 166 (1963).[10] Congress, in response, specifically overruled the Board's interpretation by amending Section 2(c) to provide a more precise definition of a "commercial bank" that would "exclude institutions like industrial banks and nondeposit trust companies." S Rep. 89-1179, 89th Cong., 2d Sess. 7 (1966).[11] Section 2(c)'s reliance on a depositor's "legal right to

[10] The Board adopted a "functional" approach similar to the approach it advances in the instant case. It ruled that acquisition of an industrial bank would be subject to the BHCA if the industrial bank "accepts deposits subject to check or otherwise accepts funds from the public that are, in actual practice, repaid on demand, as are demand or savings deposits held by commercial banks." *Ibid.* The Board reaffirmed that approach in *Industrial Banks as "Banks" Under the Bank Holding Company Act*, 51 Fed. Res. Bull. 1539 (1965), stating that the BHCA was applicable to the acquisition of an industrial bank issuing investment certificates that were "in actual practice, repaid on demand." *Id.* at 1540.

[11] The evolution of the amended definition is apparent. The American Industrial Bankers Association proposed that Section 2(c) be amended specifically to exclude industrial banks from the BHCA's coverage. *Amend the Bank Holding Company Act of 1956: Hearings on S. 2353, S. 2418, and H.R. 7371 Before a Subcomm. of the Senate Comm. on Banking and Currency*, 89th Cong., 2d Sess. 157 (1966) (hereinafter *1966 Hearings*). The Chairman of the Senate Committee requested the Board's views on the matter. The Board responded that there was "no reason in policy to cover such institutions" and suggested that industrial banks and similar institutions could be excluded by defining "bank" to include only those institutions that

withdraw" represents a congressional formulation of a clear boundary separating traditional commercial banks from industrial banks and like institutions.[12] The Board, invoking "policy" concerns, simply seeks to redraw the line that Congress has laid down.

2. Section 2(c) states, as the second element of its definition, that a "bank" must "engage in the business of making commercial loans." 12 U.S.C. 1841(c). As in the case of the "demand deposit" element, the Board has expanded the statutory requirement far beyond the "ordinary meaning of the words used." *Russello*, 464 U.S. at 21.[13] The "making of commercial loans," as the constituent words denote, involves the negotiated extension of credit to a business enter-

accept "deposits payable on demand." *Id.* at 447. The Board noted that this definition would exclude industrial banks because they "accept funds that are, *in actual practice*, repaid on demand." *Ibid.* (emphasis added). Congress modified the Board's suggested language to include only those institutions that "accept deposits that a depositor has a legal right to withdraw on demand." The reason for this change seems clear: Congress no doubt recognized that accounts "payable on demand" might be interpreted to include accounts "in actual practice, repaid on demand." It sought to clarify the Board's distinction between accounts legally payable on demand from those in practice paid on demand through a test that expressly relied on the depositor's *legal right* to withdraw on demand. Remarkably, the Board now urges against that distinction, which *it* first proposed.

[12] The Board is simply wrong in suggesting (Pet. Br. 29-31) that the "demand deposit" requirement reflects a congressional determination that all institutions offering accounts "withdrawable by check" should be treated as commercial banks. Congress was concerned solely with formulating a test that would distinguish between traditional commercial banks and other institutions. See S. Rep. 89-1179, *supra*, at 7. The Board itself suggested that the "demand deposit" requirement is "a simple and widely accepted test" for drawing that distinction. 112 Cong. Rec. 12386 (1966). Nothing in the legislative history suggests that Congress wished to regulate institutions *because* they offered checking accounts or their "functional equivalents." Indeed, the infirmity of the Board's position is best demonstrated by its result. As the Board admits (Pet. Br. 12-13, 31 n.29), its formulation would sweep within the coverage of the BHCA the very institutions that Congress specifically sought to exclude.

[13] Commercial terms are presumed to be used in their trade or commercial meaning. See 2A *Sutherland Statutory Construction* § 47.31 at 155 (4th ed. 1973).

prise.[14] It does not include the broad range of money market transactions and interbank transfers—including purchase of retail installment loans, commercial paper, certificates of deposit, and bankers' acceptances, extension of broker call loans, sale of federal funds and deposit of interest bearing funds—that the Board has swept within its amended Regulation Y.

At bottom, the Board contends that any transaction qualifies as a commercial loan if it "establishes a debtor-creditor relationship and results in an extension of credit and * * * the beneficiaries of these transactions are not individuals but rather corporations that utilize the funds for business purposes" (Pet. Br. 39; Pet. App. 48a). But the Board fails to explain the source of this novel and indecipherably vague definition. The Board's definition certainly does not conform to the "ordinary contemporary, common meaning" of the words Congress used. *Perrin*, 444 U.S. at 42. The term "commercial loans" finds a far more narrow, firmly established, and well understood usage in the banking community. Commercial loans are face-to-face agreements that a bank undertakes "to supply the credit needs of business enterprises, including farm operations, in its community." H. Crosse & G. Hempel, supra, at 176. "Commercial loans tend to be large and complex, requiring careful credit analysis and loan structuring." F. Johnson & R. Johnson, 158 (1985). They occupy a "privileged position" in a bank's loan portfolio because "bankers believe proper accommodation of commercial and industrial borrowers is essential to maintain a bank's lending base in the form of commercial deposits." D. Hodgman, supra, at 19. Section 2(c) was intended to refer

[14] *E.g.*, D. Jaffee, *Credit Rationing and the Commercial Loan Market* 3 (1971) ("The term *commercial loans* generally refers to credit of short term maturity extended by commercial banks to business. The collateral for this credit is typically a short term asset such as inventory stock or accounts receivable.") (footnote omitted; emphasis in original); see also, *e.g.*, F. Johnson & R. Johnson, *Commercial Bank Management* 158-186 (1985); H. Crosse & G. Hempel, *Management Policies for Commercial Banks* 176-180 (1973); American Bankers Ass'n, *The Commercial Banking Industry* 121-161 (1962). See generally, D. Hodgman, *Commercial Bank Loan and Investment Policy* (1963).

to this broadly embraced usage of the term "commercial loans."[15]

Government and private sectors of the banking community have criticized the Board's amended definition as inconsistent with commercial practice and understanding.[16] As the commentators pointed out, the Board itself had recognized and adhered to the common usage of the term "commercial loan" for over a decade, and its new definition marked a "radical," "abrupt," and "profound" departure from its own past practices.[17] Indeed, prior to its amendments to Regulation

[15] Curiously, the Board seeks support for its definition (Pet. Br. 39; Pet. App. 48a) in this Court's observation that "[c]ommercial loans, generally speaking, are relatively short-term loans to business enterprises of all sizes, usually for purposes of inventory or working capital." *United States* v. *Connecticut Nat'l Bank*, 418 U.S. 656, 665 (1974). The Court's observation conforms precisely to the type of loan described in the text. See, *e.g.*, *F. Johnson & R. Johnson*, *supra*, at 161-164 (describing the characteristic cyclic relationship between commercial loans, inventory, and working capital). Indeed, the Court's observation was made in reference to the type of face-to-face transactions that we have described. See App. at 170-173, 487-488, 2331-2355, *United States* v. *Connecticut National Bank*, No. 73-767.

[16] For example, the Comptroller described the Board's definition as "an abrupt and profound departure from the Board's past interpretations of the term" (J.A. 75A) that "is not supported by either the general purpose of the BHCA or the specific purpose of the 1970 narrowing of the definition of the term 'bank' " (J.A. 77A). The FDIC objected to the Board's policy decision, though not to its authority to make such rules, stating that the Board "has dramatically recast the definition of commercial loan" and made "a radical departure from the traditional view of what constitutes a commercial loan" (J.A. 91A). The regulated community likewise strenuously objected to the Board's definition. See, *e.g.*, J.A. 37A, 39A, 49A-57A.

[17] The Board's justification for its definition of a commercial loan, even before this Court, is unconvincing. For example, the Board claims (Pet. Br. 44) that this Court's decision in *Securities Industry Ass'n* v. *Board of Governors*, No. 82-1766 (June 28, 1984), supports its particular assertion that commercial paper is a commercial loan. However, that case simply notes the undisputed fact that commercial paper results in an extension of credit. Slip op. 20 & n.11. Indeed, the Board's failure to recognize basic distinctions between these commercial loans and commercial paper is well illustrated by Professor Hodgman's comparison (*Commercial Bank Loan and Investment Policy*, *supra*, at 125-126):

Y, the Board generally had described the transactions at issue as activities only "closely related" to banking. See 12 C.F.R. 225.4 (1975). Additionally, the Board repeatedly indicated that the transactions now at issue were not commercial loans. For example, the Board advised the Vice President of the Federal Reserve Bank of Boston, through a May 18, 1972 letter (J.A. 93A), that Boston Safe Deposit and Trust Company (Boston Safe) did not fall within Section 2(c)'s definition of a bank, stating (J.A. 94A):

> The Board understands that Boston Safe purchases "money market instruments," such as certificates of deposit, commercial paper, and bank acceptances. In the circumstances of this case, such transactions are not regarded as commercial loans for the purposes of the Act.
>
> * * * * *
>
> A further aspect of Boston Safe's operations is its engagement in Federal funds transactions * * *. The Board has concluded * * * that the sale of Federal funds by Boston Safe is not tantamount to the making of a commercial loan, for purposes of the Act.

> Despite the[ ] similarities in the bank loan market and the commercial paper market there is one significant difference * * *: the commercial paper market is impersonal in its negotiations because of the intervention of commercial paper brokers between buyers and sellers. This is in marked contrast to the direct negotiations between bank and customer in the bank loan market. * * * The close similarity in the relative movements of the commercial paper rate and the rate on Treasury bills [citing a graph] supports the institutional evidence that the commercial paper rate is determined under strongly competitive conditions.

See also, *e.g.*, Hurley, *The Commercial Paper Market*, 63 Fed. Res. Bull. 525 (1977). The Board also fails to recognize (Pet. Br. 44 n.55) that commercial paper, though often directly placed, is traded in a competitive market and, like all money market instruments, is subject to arbitrage. Likewise, its comparison to participation loans (*ibid.*) neglects to mention the comprehensive agreements among the lead and participating banks that distinguish these loans from market investments. As respondents note (Br. in Opp. 22-25), the Board's inclusion of other money market instruments and interbank transfers is even more difficult to justify.

The Board subsequently followed that reasoning in a variety of different contexts.[18] The Board now dismisses these decisions as simply "represent[ing] a willingness by the Board to refrain from applying the full scope of the Act in conditions that did not appear to generate the potential for its evasion" (Pet. App. 60a). However, the Board's past decisions make no mention of self-imposed restraint; instead, it appears that the Board has actually abandoned the reasonable and, indeed, self-evident interpretation of the statutory language, finding its novel definition of "commercial loan" preferable to that

[18] For example, the Board's Legal Division later advised Bradford Computer Systems, Inc., through a January 26, 1976 letter (J.A. 99A), that a broker call loan "is distinguishable from the ordinary commercial loan in that such call loans are entered into on a daily renewable basis, with both parties having the option not to renew, are made primarily as a method of investing idle funds, and are viewed by the lending institution as an alternative to purchase of money market instruments such as commercial paper or bankers' acceptances" (J.A. 101A). The Board's Legal Division advised the Federal Reserve Bank of Boston, through a November 13, 1980 letter (J.A. 104A), that the purchase of government guaranteed loans would not constitute "making commercial loans" because it "appears to be a passive medium of investment" that "do[es] not appear to involve the particular type of lender-borrower relationship that is characteristic of commercial loans" (J.A. 105A; see also *id.* at 96A-98A). The Board expressed similar views in other cases. See *D. H. Baldwin Co.*, 63 Fed. Res. Bull. 280, 286 (1977) (savings and loan institutions that engage in federal funds transactions are not banks within the meaning of Section 2(c)); *American Fletcher Corp.*, 60 Fed. Res. Bull. 868, 869 & n.8 (1974).

The Board adhered to these interpretations through early 1981. For example, it advised Gulf & Western Corporation, through a March 12, 1981 letter (J.A. 110A), concerning a subsidiary's acquisition of Fidelity National Bank (FNB), that FNB would not be a bank for purposes of Section 2(c) "since it ha[d] divested itself of its commercial loan portfolio" and had taken other action to avoid commercial loan involvement (J.A. 111A). The first appearance of a change in the Board's position occurred shortly thereafter, when the Chrysler Corporation requested the Board's views on Chrysler's proposal to form a subsidiary, for automotive financing purposes, that would make the same commitment to forego commercial loan activities. The Board advised Chrysler through a May 28, 1981 letter ([1981-1982 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 98,770) that the financing company would not be a bank provided that it also avoided purchase of "commercial paper and banker's acceptances," suggesting that these instruments "could be used as substitutes for commercial loans." *Ibid.* However, the Board expressly permitted Chrysler to invest in certificates of deposit. *Ibid.*

which the plain language provides.

The legislative history fully supports interpretation of "commercial loan" according to its plain meaning.[19] In 1966, Congress narrowed the BHCA's definition of a "bank" to include only those institutions that accepted "demand deposits" (see discussion, pages 15-16 *supra*). By 1970, Congress had recognized that this definition was still too broad, and therefore added the "commercial loan" requirement. As the Senate Report explained (S. Rep. No. 91-1084, 91st Cong., 2d Sess. 24 (1970)):

> The definition of "bank" adopted by Congress in 1966 was designed to include commercial banks and exclude those institutions not engaged in commercial banking, since the purpose of the act was to restrain undue concentration of commercial banking resources and to prevent possible abuses related to the control of commercial credit. However, the Federal Reserve Board has noted that this definition may be too broad and may include institutions which are not in fact engaged in the business of commercial banking in that they do not make commercial loans. The committee, accordingly, adopted a provision which would exclude institutions that are not engaged in the business of making commercial loans from the definition of "bank."

The discussion of commercial loans in the context of commercial banks is revealing; it demonstrates that Congress understood and used the term "commercial loan" in the same sense

[19] In amending Regulation Y, the Board rejected a definition based on "those transactions traditionally denominated 'commercial loans,'" claiming that "[t]here is nothing in the legislative history that supports such a proposition" (Pet. App. 47a; see Pet. Br. 44). Not only is this statement wrong, it completely ignores "the familiar canon of statutory construction that the starting point for interpreting a statute is the language of the statute itself. Absent a *clearly expressed legislative intention to the contrary*, that language must ordinarily be regarded as conclusive." *Consumer Product Safety Comm'n* v. *GTE Sylvania, Inc.*, 447 U.S. at 108 (emphasis added). Thus, it is *the Board* that must show some compelling basis for departure from the plain language of the statute. See *TVA* v. *Hill*, 437 U.S. at 187 n.33. See also *Escondido Mutual Water Co.* v. *La Jolla Band of Mission Indians*, No. 82-2056 (May 16, 1984), slip op. 6; *Rubin* v. *United States*, 449 U.S. 424, 430 (1981).

that it was employed by commercial banks. Congress plainly did not express any intention that the term should receive a definition other than that applied in ordinary commercial usage.

The Board contends (Pet. Br. 41) that the "commercial loan" requirement should not be applied according to its plain meaning because it "was a technical amendment to the Act designed to create a narrowly circumscribed exclusion from the Act's coverage," noting that a particular institution, Boston Safe, proposed the requirement.[20] Congress was fully aware that Boston Safe actively campaigned for and would benefit from the amendment, but there is no indication that Congress intended to benefit only Boston Safe; indeed, both the statute and the Senate Report speak of the "commercial loan" requirement as a limitation of general applicability.[21]

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[20] Boston Safe, which accepted demand deposits but made loans only as a courtesy to trust customers, first urged the amendment in 1966. See *1966 Hearings*, 732-733 (Letter from William Wolbach, President, The Boston Co., Inc., to Sen. A. Willis Robertson, Chairman, Senate Comm. on Banking and Currency (Apr. 28, 1966)). See also 112 Cong. Rec. 12385-12386 (1966). In 1970, Senator Brooke of Massachusetts introduced a bill to amend the BHCA that included, presumably at Boston Safe's urging, the "commercial loan" requirement. See S. 3823, 91st Cong., 2d Sess. § 21(c) (1970), *reprinted in* 116 Cong. Rec. 14821 (1970). The Senate Committee on Banking and Currency included the "commercial loan" requirement in the Senate bill, see S. Rep. 91-1084, *supra*, at 24, and the Senate and House conferees included the requirement in the final bill. See 116 Cong. Rec. 42426 (1970) (comments of Senator Sparkman); Act of Dec. 31, 1970, Pub. L. No. 91-607, § 101(c), 84 Stat. 1762. See also P. Heller, *Handbook of Federal Bank Holding Company Law* 10 n.30 (1976).

[21] The Board, in its review of the "commercial loan" requirement contained in S. 3823, stated, "To the best of our knowledge, this amendment would have very limited application at present, possibly affecting only one institution." Letter from J. L. Robertson, Vice Chairman, Board of Governors of the Federal Reserve System, to Sen. John Sparkman, Chairman, Senate Comm. on Banking & Currency (June 1, 1970), *reprinted in "One-Bank Holding Company Legislation of 1970," Hearings Before the Senate Comm. on Banking and Currency*, 91st Cong., 2d Sess. 136-137 (1970) (hereinafter *1970 Hearings*). The Board's recitation of this statement (Pet. Br. 41) is slightly mistranscribed and omits inclusion of the phrase "at present." The passage, correctly quoted, confirms that the Board viewed the "commercial loan" requirement as a limitation of general applicability. Likewise the Board has incorrectly attributed a statement to Rep. Gonzalez

Moreover, the congressional intention to exclude Boston Safe through the "commercial loan" requirement confirms the plain meaning of the term "commercial loan." As the Board acknowledges (Pet. Br. 43), Boston Safe was engaged in the very type of money market transactions that the Board now claims are "commercial loans."[22]

The Board argues further that the "commercial loan" requirement should be construed more broadly than its accepted meaning because other 1970 amendments to the BHCA "substantially reaffirmed and strengthened the regulatory framework of the Act" (Pet. Br. 42). How-

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that Boston Safe was "[v]irtually the only bank that does no commercial lending" (*ibid.*). That statement actually appeared in a lengthy banking journal article that Rep Gonzalez entered into the record. See 116 Cong. Rec. 25846-25849 (1970).

[22] As previously discussed (see page 19, *supra*), Boston Safe purchased certificates of deposit, commercial paper and bankers' acceptances, and participated in the federal funds market. See J.A. 93A-95A; see also Financial Statement of Boston Safe Deposit & Trust Co. (Dec. 31, 1970), *summarized in* Moody's Investor Service, Inc., *1972 Moody's Bank and Finance Manual* 663-664 (stating that, as of Dec. 31, 1970, Boston Safe had $37,250,000 invested in short-term market investments); Financial Statement of Boston Safe Deposit & Trust Co. (June 31, 1970), *summarized in* R.L. Polk & Co., *Polk's World Bank Directory* 6 (Sept. 1970) (Massachusetts section) (stating that Boston Safe, as of June 30, 1970, had $6,600,000 of federal funds sales). The Board contends (Pet. Br. 43-44) that this fact should be ignored, suggesting that it was unknown to Congress and the Board. The legislative history does not indicate whether or not Congress knew of Boston Safe's investment activities, but the information was readily available if either were interested. If Congress verified these activities, that is the end of the debate. If Congress did not, two inferences can be drawn. First, Congress's might have considered such activities irrelevant because it was only interested in imposing the BHCA's requirements on commercial banks that offered "ordinary commercial loans." See 112 Cong. Rec. 12385 (1966) (comment of Sen. Robertson, noting that "the committee received evidence with respect to trust companies which do not make ordinary commercial loans"). Second, Congress might have failed to consider the possibility that the term "commercial loans" could be interpreted to include money market transactions and interbank transfers precisely *because* the term did not connote such activities. Thus, Boston Safe's transactions support a plain language interpretation of the term "commercial loan," regardless of whether Congress was aware of them or not.

ever, there is nothing unusual in Congress imposing greater regulation in certain provisions of an Act, while relaxing regulatory burdens in other provisions. Likewise, the Board's reliance (*ibid.*) on the House conferees' general observation that various exemptions should be construed narrowly, see H.R. Rep. 91-1747, 91st Cong., 2d Sess. 23 (1970), does not permit a construction at odds with the plain language of the statutory language.[23]

In sum, the plain meaning of Section 2(c) precludes the Federal Reserve Board's expansive redefinition of its operative terms "legal right to withdraw" and "commercial loans." Congress, through Section 2(c), has drawn a line in light of competing policies. The Board may not agree with that line, but it is obligated to respect it unless and until it is redrawn by Congress. Thus, the court of appeals correctly invalidated the Board's amended Regulation Y.

B. The Board's Power to Administer the Bank Holding Company Act Does Not Permit It to Expand the Scope of the Act's Coverage.

The United States, perhaps more than any other litigant, recognizes the importance of judicial deference to the effective functioning of administrative agencies. We have frequently argued before this Court and other tribunals that an agency's responsibility to administer a congressionally created program necessarily requires substantial latitude in interpreting uncertain statutory terms. But we also recognize that "[t]he judiciary is the final authority on issues of statutory construction and must reject administrative interpretations which are contrary to clear congressional intent." *Chevron U.S.A. Inc.*, slip op. 4 n.9. In the present

[23] Congress is aware of the distinctions between commercial loans and investment transactions; it generally indicates when it wishes non-loan extensions of credit included within a statutory provision. See *e.g.*, 12 U.S.C. 84 (lending limits apply to "[t]he total loans and extensions of credit by a national banking association * * *"); 12 U.S.C. 371c (restrictions on transactions with affiliates apply to "covered transactions" defined as, inter alia, "a loan or extension of credit to the affiliate"). See also 12 U.S.C. 1464(c) (distinguishing a savings and loan association's commercial loan activities from a variety of other loans and investments).

case, we believe that "the intent of Congress is clear," and "that is the end of the matter; for the court, as well as the agency must give effect to the unambiguously expressed intent of Congress." *Id.* at 4.

In our view, the Board's expansive redefinition of the operative terms of Section 2(c) represents an " 'unauthorized assumption by an agency of major policy decisions properly made by Congress.' " *Bureau of Alcohol, Tobacco, & Firearms* v. *FLRA*, 464 U.S. 89, 97 (1983), quoting *American Ship Building Co.* v. *NLRB*, 380 U.S. 300, 318 (1965). Indeed, the Board's brief is devoted in large part to contentions of policy (see Pet. Br. 18-27, 33-35, 44-46) rather than considerations of congressional intent.[24] One can debate the wisdom of the Board's policy analysis; there is ample room to dispute whether institutions that offer NOW accounts and engage in money market transfers should in the future be subject to the strictures of the BHCA. But that is not the point. The question before this Court is not the content of the debate but rather where it should take place. And the answer to that question is clear: "Resolution of the pros and cons of whether a statute should sweep broadly or narrowly is for Congress." *United States* v. *Rodgers*, No. 83-620 (Apr. 30, 1984), slip op. 8.

[24] The Board largely ignores the BHCA's specific statutory language; instead, it urges this Court (Pet. Br. 33) to rely on "the policies of the legislation as a whole," citing *United States* v. *American Trucking Ass'n, Inc.*, 310 U.S. 534 (1940). But as that case notes, "there is no more persuasive evidence of the purpose of the statute than the words by which the legislature undertook to give expression to its wishes." *Id.* at 543. Those words should be applied unless absurd results or consequences obviously at variance with the legislation will result. *E.g.*, *United States* v. *Rutherford*, 442 U.S. 544, 552 (1979). In the present case, the Board has failed to demonstrate absurdities or obvious variances; instead, it simply disagrees with the line Congress has drawn between "banks" and other institutions. But Congress exists to draw such lines. Indeed, it is altogether familiar for Congress to reconcile competing policies by drawing a line that might seem arbitrary if viewed solely from one particular policy perspective. See, *e.g.*, *Dawson Chemical Co.* v. *Rohm & Haas Co.*, 448 U.S. 176, 220-223 (1980). If legislative compromise is to be respected, then those lines—until altered by Congress—must be observed.

Once the Board's unconvincing hermeneutical efforts are set aside, it becomes apparent that the Board's desire to redefine the content of Section 2(c) is based simply on its own policy preferences. The Board perceives changes in the financial services industry and believes that these changes should be addressed through regulatory redefinition of statutory terms. Its actions cannot be justified as necessary to prevent evasions of the Act.[25] No matter how persuasive its policy arguments and how well-intentioned its motives, the Board's action seriously undermines the legislative process. See *Rodgers*, slip op. 7-8.

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[25] Section 5(b) of the BHCA authorizes the Board to issue regulations and orders necessary to carry out the purposes and prevent evasions of the Act. 12 U.S.C. 1844(b). The Board suggests at several junctures (Pet. Br. 17, 25, 33, 37-38) that its redefinition of the terms "legal right to withdraw" and "commercial loan" represents a valid exercise of that power. But Section 5(b) only empowers the Board to police the boundaries of the Act; it does not permit the agency to redraw the borders that Congress has plainly marked between "banks" and other financial institutions. See *FAIC Securities* v. *United States*, No. 84-5408 (D.C. Cir. July 26, 1985), slip op. 19 ("[a] general authority to define terms * * * does not confer power to *redefine* those terms that the statute itself defines"). At bottom, the Board simply claims that, because it has broad enforcement powers, it can enlarge the statute's prohibitions. Although the Board has indisputably broad authority within the four corners of the BHCA, it cannot expand the perimeters of the Act's coverage to reach conduct that Congress has plainly placed beyond its reach. A different case would be presented if Congress had phrased the scope of Act's coverage in uncertain terms, or had expressly delegated authority to the Board to define its outer contours. See *Mourning* v. *Family Publications Service, Inc.*, 411 U.S. 356, 365-366 (1973) In the present case, Congress has set forth the outer reach of the Act with specificity.

Thus, the Board's reliance (Pet. Br. 37) on *Wilshire Oil Co.* v. *Board of Governors*, 668 F.2d 732 (3d Cir. 1981), cert. denied, 457 U.S. 1132 (1982), is misplaced. As the Board itself has recently explained, *Wilshire* involved the application of the Board's Section 5(b) powers in a situation "where a financial institution whose activities already satisfied the definition of a 'bank' sought to place itself outside the Act's coverage without altering any of the banking activities actually performed by the bank." Brief for Respondent Board of Governors at 28, *Florida Bankers Ass'n* v. *Board of Governors*, 760 F.2d 1135 (11th Cir. 1984), petition for cert. pending, No. 85-193. *Wilshire* does not support the Board's apparent position that Section 5(b) permits the Board to alter the statutory criteria for determining *whether* an institution is within or without the coverage of the Act.

"If, as petitioner contends, there is now a compelling need to fill the gap in the [agency]'s regulatory authority, the need should be met in Congress where the competing policy questions can be thrashed out and a resolution found." *FMC* v. *Seatrain Lines, Inc.*, 411 U.S. 726, 744-745 (1973). The court of appeals quite properly refused to give the Board license "to meet that need by rewriting the statute and legislative history [itself]." *Id.* at 745. The Board's perception of the need to regulate new and changing financial institutions cannot justify administrative amendment of longstanding legislation. See *United States* v. *Lorenzetti*, No. 83-838 (May 29, 1984) slip op. 11. ("It is for Congress, not the courts, to revise longstanding legislation in order to accommodate the effects of changing social conditions."). See also *Morrison-Knudsen Construction Co.* v. *Director, Office of Workers Compensation Programs*, 461 U.S. 624, 635 (1983).

The Board's unilateral redefinition of the BHCA's reach is particularly troubling because it would dramatically change the present bank regulation scheme. Institutions that Congress expressly intended to exempt from the coverage of the BHCA, such as industrial banks (see note 12, *supra*) and trust institutions that do not engage in commercial lending (see note 22, *supra*) would be swept back within the coverage of the BHCA. Other state-insured institutions would be required to obtain FDIC deposit insurance (see 12 U.S.C. 1842(e)) even though they may be ineligible for insurance from that source. Thus, reasonable, industry-wide expectations will be disrupted.[26]

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[26] The Board acknowledges that these disruptions would take place (Pet. Br. 45-46) but makes little effort to resolve the quandary it has created. It suggests that the institutions swept back within the Act "are not the same type of institutions that Congress intended to exclude" (Pet. Br. 13). But that, most certainly, is a determination for Congress. The Board suggests that it might grant "hardship" exemptions. 12 C.F.R. 225.21(b)(4); see 49 Fed. Reg. 799, 823 (1984). But that seems to be a doubtful solution; the District of Columbia Circuit has held that an agency cannot enact regulations otherwise beyond its authority by providing variances "that perhaps will be used to bring the agency's regulations within the boundaries established by the statute." *In re Surface Mining Regulation Litigation*, 627 F.2d 1346, 1358-1359 (1980). Finally, the Board addresses the insurance issue by simply inviting Congress to cure the problem that the Board has created (Pet. App. 44a).

If "reasonable expectations are to be altered, that is a task for Congress, *J.W. Bateson Co.* v. *United States ex rel Board of Trustees,* 434 U.S. 586, 593 (1978)." *Morrison-Knudsen Construction Co.*, 461 U.S. at 636. Plainly, whether and how NBBs should be regulated are questions that fall squarely within the legislative domain. Congress is attentive to changes in the financial services industry; it has frequently modified the BHCA in response to the industry's evolution.[27] It is altogether proper to await congressional resolution of the NBB controversy, particularly since Congress, through recent deregulatory legislation, has itself encouraged many of the activities that the Board views as "evasions" of the BHCA. Indeed, Congress is presently considering BHCA amendments addressing the NBB issue that differ markedly from the Board's regulations.[28] Congressional deliberations should continue to conclusion unencumbered by agency efforts, however well intentioned, to forestall the legislative debate.[29]

[27] Congress amended Section 2(c) most recently in the Garn-St. Germain Depository Institutions Act of 1982, Pub. L. No. 97-320, § 333, 96 Stat. 1504; see 12 U.S.C. 1841(c), to prevent BHCA coverage of savings and loan institutions. The amendment was necessary to prevent coverage of savings and loan institutions under both the BHCA and the Savings and Loan Holding Company Act, 12 U.S.C. 1730a *et seq.* Under the Garn-St Germain Act, savings and loan associations received authorization to accept demand deposits from certain customers, see 12 U.S.C. 1464(b)(1)(A) and (B), and to make commercial loans, 12 U.S.C. 1464(c)(1)(R). Accordingly they "conceivably could be required to meet the requirements" of both Holding Company Acts. See S. Rep. 97-536, 97th Cong. 2d Sess. 55 (1982). The Board contends (Pet. Br. 46) that Congress's exemption of savings and loan associations creates an inference that Congress intended other institutions to be covered by the BHCA. The Board is, of course, plainly wrong—Congress found it necessary to exempt savings and loans because they now could offer conventional demand deposit accounts and make conventional commercial loans. Indeed, the Garn-St Germain Act supports just the opposite inference. The Act's provisions distinguish between savings accounts, (including NOW accounts), see 12 U.S.C. 1464(b)(1)(A) and (E)) and demand accounts, see 12 U.S.C. 1464(b)(1)(B). They also demonstrate that Congress is responsive to changes in the financial services industry and expands or contracts the BHCA's plain language as the need arises.

[28] For example, S. 2851, passed in the Senate at the close of the 98th Congress, defined the term "bank" to include FDIC insured institutions and any institution that "accepts demand deposits or deposits that the depositor may withdraw by check or similar means * * * and is engaged in the business of making commercial loans." S. 2851, 98th Cong., 2d Sess. § 104(a)(1)(1982). But it defined "commercial loan" expressly to exclude investments such as commercial paper, certificates of deposit and other money market and interbank instruments. *Id.* § 104(a)(3). See 130 Cong. Rec. S11163 (daily ed. Sept. 13, 1984). Notably, both the Federal Reserve Board and the Department of the Treasury worked with the Senate Committee in formulating S. 2851 and both generally supported that legislation.

In sum, it is clear that the Board has exceeded its authority and usurped congressional perogative by redefining, through amendments to Regulation Y, the operative terms of Section 2(c) of the BHCA. The court of appeals correctly invalidated the Board's action.

[29] The respondents note (Br. Opp. 12 n.17) that a number of individual legislators have questioned whether it was appropriate for the Board to promulgate regulations on an issue that is presently the subject of legislative debate—a debate that has entertained the views of the Federal Reserve Board and all other sectors of the banking community.

CONCLUSION

For the foregoing reasons, the court of appeals' judgment should be affirmed.

Respectfully submitted.

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SEPTEMBER 1985

No. 84-1274

IN THE

Supreme Court of the United States

OCTOBER TERM, 1985

BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM,
Petitioner,

v.

DIMENSION FINANCIAL CORPORATION, *et al.*,
Respondents.

On Writ of Certiorari to the United States Court of Appeals For the Tenth Circuit

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BRIEF OF SEARS, ROEBUCK AND CO., ALLSTATE ENTERPRISES, INC., AND GREENWOOD TRUST COMPANY AS AMICI CURIAE IN SUPPORT OF RESPONDENTS

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QUESTION PRESENTED

Sears, Roebuck and Co. and its affiliates, Allstate Enterprises, Inc. and Greenwood Trust Company, will address the following question: Whether the Congress of the United States, in enacting and amending the Bank Holding Company Act, 12 U.S.C. §§ 1841 *et seq.*, intended to establish and implement a national policy of separating banking and commerce.

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IN THE

Supreme Court of the United States

OCTOBER TERM, 1985

No. 84-1274

BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM,

Petitioner,

v.

DIMENSION FINANCIAL CORPORATION, *et al.*,

Respondents.

BRIEF OF SEARS, ROEBUCK AND CO., ALLSTATE ENTERPRISES, INC., AND GREENWOOD TRUST COMPANY AS AMICI CURIAE IN SUPPORT OF RESPONDENTS

INTEREST OF THE AMICI CURIAE

This case concerns the power of the Board of Governors of the Federal Reserve System (the "Board"), acting under authority purportedly conferred by the Bank Holding Company Act as amended, 12 U.S.C. §§ 1841 *et seq.* (the "BHCA" or the "Act"), to redefine (through the Board's Regulation Y, 12 C.F.R. § 225) specific terms in § 2(c) of the BHCA, 12 U.S.C. § 1841(c).[1] Such redefinition, if allowed to stand, will bring within the Board's regulatory authority the corporate owners of depository institutions that had not previously been defined as "banks"

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[1]*See infra* note 16.

within the meaning of the Act. These institutions are characterized by the Board as "nonbank banks," but are referred to herein as "non-BHCA banks."[2]

Sears, Roebuck and Co., through its subsidiary Allstate Enterprises, Inc., controls the Greenwood Trust Company (together, "Sears"), an insured non-BHCA bank chartered in the State of Delaware that makes no commercial loans. The Board's brief makes clear that its intention in amending Regulation Y is to hinder the development of such non-BHCA banks. If successful, the Board's action will have a substantially adverse impact on Sears, on its financial services business, and on the financial services alternatives made available to the American consumer by Sears and other diversified financial services firms.

Sears is particularly concerned that the Board, having repeatedly failed to obtain approval of Congress for the expansion of its authority with respect to non-BHCA banks, is seeking to achieve such an expansion through unilateral administrative fiat, advancing in support of its action the myth that the BHCA implements a national policy of separating banking and commerce. Because the adoption by this Court of the Board's view of the BHCA would harm Sears, as well as the interests of consumers, Sears believes it can offer this Court a useful perspective on whether Congress intended in the BHCA to separate banking and commerce or intended in general to apply the Act to institutions other than commercial banks as Congress carefully and narrowly defined that term in 1970.

This brief is filed pursuant to Rule 36.2 of the Rules of this Court. The parties have consented to the filing of this brief. Their letters of consent have been filed with the Clerk of the Court.

INTRODUCTION

Central to the Board's argument in this case is its assertion that the BHCA is "a comprehensive federal framework" to

[2]*See infra* note 17.

implement a "national polic[y] requiring a separation of banking and commerce in this country...." *See* Pet. Br. at 2-3, 10, 12, 13, 16, 18, 20. This contention allows the Board to link its actions to an alleged congressional policy and thereby to claim for itself a range of authority that it has been repeatedly denied by Congress. In fact, however, Congress never intended to establish, and has not established, a national policy of separating banking and commerce.

Since at least 1943, the Board has regularly urged Congress to "separate banking and commerce" by restricting, and authorizing the Board to regulate, the activities of organizations that own or control all depository institutions.[3] Despite the Board's repeated requests, Congress has consistently refused to draw a line between banking and commerce; instead, the actions of Congress have been far more limited, reflecting almost entirely a desire to constrain the economic power of commercial banks.

When Congress has acted, it has addressed specific manifestations of this power as they arose, going no further than necessary to achieve its limited objectives. Its actions have reflected a careful balancing of the Board's requests for sweeping authority to separate banking and commerce with a sensitive concern for maintaining competition and flexibility in the economy.

Integral to achievement of these congressional goals is the definition of "bank" in the BHCA. In defining that term, Congress evinced a keen awareness of the term's significance as the fulcrum of the Board's jurisdiction. When enacted in 1956, the Act was intended to include only commercial banks,[4] but failed to implement this intent clearly.[5] Consequently, Congress amended the definition in 1966 and again in 1970, each time

[3]*See infra* pp. 9-10.

[4]102 *Cong. Rec.* 6,857 (1956) (statement of Sen. Robertson).

[5]"Bank" was defined by the 1956 Act as "any national banking association or any State bank, savings bank, or trust company. . . ." Bank Holding Company Act of 1956, Ch. 240, § 2(c), 70 Stat. 133, 12 U.S.C. § 1841(c)(1)(1956).

narrowing the statutory language so that the BHCA could be applied by the Board only to the holding companies of what Congress repeatedly referred to as "commercial banks."[6]

The Board simply asserts in its brief that the depository institutions which it brought within the BHCA by revising Regulation Y are commercial banks. *See* Pet. Br. at 21. But this assumes the issue the Board is required to prove. As this brief will show, by adopting a specific and literal test for defining commercial banks in 1966 and 1970, Congress clearly reserved to itself the authority to expand the reach of the BHCA to other depository institutions. This Court should reject the Board's attempt to overreach its limited mandate and usurp the exclusive power of Congress to determine national banking policy through plenary legislation.

SUMMARY OF ARGUMENT

As originally enacted in 1956, the BHCA applied *only* to companies that owned two or more institutions chartered as banks under state or federal law.[7] This permitted the continued ownership of banks by commercial firms and the continued acquisition by one-bank holding companies of nonbanking businesses. Many such relationships were then in existence.[8] The Board urged Congress in 1955 to include holding companies of a single bank in the proposed legislation, asserting that only in this way could banking and commerce be separated.[9] Congress refused to do so. The legislative history of the 1956 Act shows clearly that Congress was concerned principally with limiting

[6]*See, e.g.*, S. Rep. No. 1084, 91st Cong., 2d Sess. 24 (1970) (definition changed because the 1966 definition included "institutions which are not in fact engaged in commercial banking"); S. Rep. No. 1179, 89th Cong., 2d Sess. 7 (1966) (redefinition needed to avoid covering companies not commercial banks).

[7]Ch. 240, § 2(a), 70 Stat. 133, 12 U.S.C. § 1841(a)(1)(1956).

[8]*See infra* note 25.

[9]Statement of William McChesney Martin, Jr., Chairman, Board of Governors, Federal Reserve System, *Control and Regulation of Bank Holding Companies: Hearings on H.R. 2674 before the House Committee on Banking and Currency*, 84th Cong., 1st Sess. 15 (1955).

the economic power of a few large multi-bank holding companies of commercial banks and not otherwise disturbing existing relationships involving only a single bank.[10]

Congress addressed the BHCA again in 1966, deleting some of the exemptions for multi-bank holding companies it had adopted in 1956. Once again, the Board urged Congress to separate banking and commerce by applying the Act to the holding companies of a single bank.[11] Congress again refused. S. Rep. No. 1179, *supra* note 6, at 5.

For purposes of the issue now before this Court, the most significant element of the 1966 amendments was a change in the definition of bank. Congress: (i) overruled a 1963 Board interpretation that used a functional ("actual practice") test to bring the corporate owners of industrial banks within the coverage of the Act, 49 Fed. Res. Bull. 166 (1963); (ii) rejected compromise language advanced by the Board;[12] and (iii) substituted a specific definition of bank that reduced the Board's interpretive latitude by focusing on the legal rights of the depositor. Congress stated clearly that its purpose in redefining the term bank in 1966 was to make wholly clear that the BHCA was intended to apply only to the holding companies of commercial banks. S. Rep. No. 1179, *supra* note 6, at 7.

Between 1966 and 1970, the issue for Congress changed considerably. Using the one-bank holding company format, large commercial banks began to expand into nonbanking activities. Concern developed in Congress that the substantial economic power of large commercial banks would be enhanced in a new way: by providing preferential financing to commercial enterprises affiliated with these banks through holding companies. S. Rep. No. 1084, *supra* note 6, at 2-4. This impelled

[10]*See* S. Rep. No. 1095, 84th Cong., 1st Sess. 7-8, 12 (1955); *see also* 102 *Cong. Rec.* 6,936 (1956) (statement of Sen. Fulbright).

[11]Statement of William McChesney Martin, Jr., Chairman, Board of Governors, Federal Reserve System, *Amend the Bank Holding Company Act of 1956: Hearings on S.2353, S.2418 and H.R. 7371 Before Subcomm. of the Senate Committee on Banking and Currency*, 89th Cong., 2d Sess. 58 (1966).

[12]*See infra* note 29.

Congress in 1970 to extend the BHCA to the holding companies of a single commercial bank. In doing so, however, Congress provided more latitude for bank holding companies to expand and compete in areas of commerce "closely related to banking" in which banks themselves traditionally could not engage.[13] Once again, the consistent theme of congressional action was not the separation of banking and commerce but the imposition of statutory constraints on the economic power of commercial banks.

That Congress has never intended to establish a policy of separating banking and commerce is further demonstrated by its actions since 1970. For example, in the Garn-St Germain Act of 1982 ("Garn-St Germain"),[14] Congress authorized federal savings and loan associations and savings banks to exercise the traditional powers of commercial banks by making commercial loans and establishing demand deposits for their commercial loan customers.[15] If Congress were truly concerned about "separating banking and commerce," as the Board asserts, surely it would have applied that policy to a class of institutions that it had authorized to exercise all the powers of commercial banks. However, Congress did not take this step. Instead, Garn-St Germain specifically exempted these institutions from the "comprehensive framework" of the BHCA, permitting their affiliates to be regulated only by the Savings and Loan Holding Company Act, 12 U.S.C. §§ 1730a *et seq.*, which imposes no restrictions on the activities of a company that owns or controls a single savings and loan association or federal savings bank. *See infra* note 43.

[13]*See, e.g.*, 116 *Cong. Rec.* 42,422 (1970) (statement of Sen. Sparkman) (Amendments provide greater regulatory flexibility).

[14]Garn-St Germain Depository Institutions Act of 1982, Pub. L. No. 97-320, 96 Stat. 1469 (1982).

[15]*Id.* at § 312, 96 Stat. 1469, 1496, 12 U.S.C. § 1464(b) (1985) (authority to establish demand deposits for commercial loan customers); *id.* at § 325, 96 Stat. 1469, 1500, 12 U.S.C. § 1464(c)(1) (authority to make commercial loans).

The actions of Congress thus squarely refute the Board's assertion that Congress has established, in the BHCA or otherwise, a "comprehensive federal framework" to implement a "national polic[y] requiring a separation of banking and commerce in this country."

ARGUMENT

The Bank Holding Company Act Was Not Intended To Separate, and Has Not Separated, Banking and Commerce

In attempting to justify a reversal of its longstanding interpretation of Section 2(c) of the BHCA, 12 U.S.C. § 1841(c) (1985)[16], the Board rationalizes and defends its actions by arguing that Congress intended through the BHCA to effect the "separation of banking and commerce." This convenient and imprecise phrase is offered to portray non-BHCA banks[17] as

[16]In a series of decisions culminating in the promulgation in January 1984 of a revised Regulation Y under the BHCA, the Board reversed positions it had taken over many years concerning the meaning of the term "bank," defined under section 2(c) of the BHCA as any institution that "(1) accepts deposits that the depositor has a legal right to withdraw on demand, and (2) engages in the business of making commercial loans." *Compare* the Board's new position under Regulation Y *with, e.g.*, its approval of the acquisition and operation by a subsidiary of the large commercial firm, Gulf & Western Industries, Inc., of the Fidelity National Bank (later renamed Associates National Bank). *See* Bank Admin. Institute Innerline, Index of Bank Performance (1982) (J.A. 108A).

[17]Non-BHCA banks are characterized, in the Board's brief and elsewhere, as "nonbank banks." This terminology may convey the misleading impression that these institutions are somehow extralegal and not otherwise subject to federal or state laws governing the activities of depository institutions. However, depository institutions that do not meet the definition of bank in Section 2(c) of the BHCA are in all other respects banks within the meaning ordinarily ascribed to that term. Thus, these institutions are chartered under state or federal law, regulated by state and federal bank regulatory authorities, fully subject to all applicable federal and state laws governing depository institutions, eligible for federal deposit insurance, and for the most part offer deposits insured by the Federal Deposit Insurance Corporation. *See, e.g.*, 12 U.S.C. § 1818 (regulatory powers of the FDIC for all "insured banks," including cease-and-desist orders); Cal. Fin. Code §§ 1900-1914 (Deering 1985) (banks); Cal. Fin. Code §§ 18390-18393 (Deering 1985) (industrial loan companies); N.Y. Banking Law § 14 (McKinney 1985); Va. Code §§ 6.1-3 to 6.1-125 (1985) (banks); and Va. Code §§ 6.1-227 to 6.1-242 (1985) (industrial loan associations).

"evasions" of the Act, *see, e.g.*, Pet. Br. at 11, and to provide otherwise nonexistent legislative authorization for the Board's functional construction of language carefully chosen by Congress to confine the Board's jurisdiction.

As the following discussion will show, the Board's premise is a fiction. The BHCA, at its inception and in each of its amendments, reflects a series of attempts by Congress to limit the economic power of the nation's commercial banks; it was not at its enactment and is not today a statute that "separates banking and commerce." Congress has never adopted the Board's expansive slogan as an expression of national policy.[18] Congressional actions, on the contrary, especially when viewed in the context in which they were taken, were specific and narrowly tailored, intended to restrict the perceived economic power of commercial banks, while leaving other sectors of the financial economy free to compete.

The Board's arguments concerning the alleged dangers of non-BHCA banks are neither unique to this case nor confined to the judicial branch. The Board has made substantially the same arguments to Congress over the past four years, all as part of an unsuccessful effort to obtain legislation that would close what the Board chooses to characterize as the "nonbank bank loophole."[19] In advancing these arguments before this Court, the Board is simply seeking to obtain from the judiciary

[18]In reviewing the legislative history of the BHCA, care should be taken not to confuse rhetoric incorporating the catch-phrase "separation of banking and commerce" with a national policy actually adopted by Congress. The phrase was frequently employed in the legislative history of the BHCA. *See, e.g.* Individual Views of Rep. Patman, H.R. Rep. No. 387, 91st Cong., 1st Sess. 27 (1969); 115 *Cong. Rec.* 33,132 (1969) (statement of Rep. Boland); S. Rep. No. 1179, *supra* note 6, at 2-3; 102 *Cong. Rec.* 6,853 and 6,919 (1956) (statements of Sens. Robertson, Barkley and Capehart); 102 *Cong. Rec.* 6,936 (1956) (statement of Sen. Fulbright). It is, however, the substance of statutes enacted by Congress, not catch-phrases or slogans, that establishes and implements a national policy.

[19]*See, e.g.*, P. Volcker, Statement before the Subcommittee on Financial Institutions, Supervision and Regulation of the House Committee on Banking, Finance and Urban Affairs 1 (April 17, 1985).

an objective—control over all companies that own depository institutions—that it has repeatedly been denied by Congress.

A. The Board's Early Attempts to Obtain Legislation

Prior to 1933, there was no federal restriction on the common ownership of banks and commercial firms. The first such restriction appeared in the Banking Act of 1933 (the Glass-Steagall Act), which restricted the ability of a company to own both a Federal Reserve member bank and an investment banking firm.[20] In 1938, 1941, 1945, 1947, 1949, 1950, 1953 and 1954 the Board unsuccessfully urged more comprehensive legislation. *See* S. Rep. No. 1095, *supra* note 10, at 3-4. In 1943, for example, the Board articulated its case for more authority in the following terms:

> There is now no effective control over the expansion of bank holding companies either in banking or in any other field in which they may choose to expand. Moreover, the device lends itself readily to the amassing of vast resources obtained largely from the public which can be controlled and used by a few people and which give to them, when they choose so to use them, an unfair and overwhelming advantage in acquiring additional properties and in carrying out an unlimited program of expansion. . . . The Board believes, therefore, that it is necessary in the public interest and in keeping with sound banking principles that the activities of bank holding companies be restricted solely to the banking business and that their activities be regulated, as are the activities of the banks themselves. . . . [T]he Board recommends that immediate legislation be enacted preventing further expansion of existing bank holding companies or the creation of new bank holding companies.

30 *Annual Report of the Board of Governors* 37 (1943).

Congress was not moved by this or similar appeals. Only in 1956, after the courts rejected the Board's effort to apply the

[20]Banking Act of 1933, Ch. 89, §§ 16 and 19, 48 Stat. 162, 184-85 and 188.

Clayton Act to Transamerica Corporation — then the nation's largest multi-bank holding company — did Congress provide the Board with additional authority over bank holding companies by enacting the BHCA. *Transamerica Corp. v. Board of Governors of Federal Reserve System*, 206 F.2d 163 (3d Cir. 1953).

B. The BHCA of 1956

The Board had sought unsuccessfully to control the expansion of the Transamerica Corporation since the early 1940s. *See* Cagill, *Branch, Chain and Group Banking* in *Banking Studies* 131-38 (1941). *See generally Peoples Bank v. Eccles*, 161 F.2d 636 (D.C. Cir. 1947), *rev'd on other grounds*, 333 U.S. 426 (1948). Finally, in 1952, the Board instituted Clayton Act proceedings against Transamerica in an effort to break up that corporation's control of banks in five Western states.

The Third Circuit set aside the Board's divestiture order. Although Transamerica controlled 645 commercial banking offices in a five-state area — representing 41% of all such offices and 39% of all commercial bank deposits — the Board's determination in another context that the "business of commercial banks is largely local" was found by the court to be inconsistent with the Clayton Act's "substantially lessen competition" test. 206 F.2d, at 167-70.

Debate in Congress on the BHCA focused heavily on the dangers Congress saw in the growth of Transamerica.[21] Congress viewed Transamerica's nonbanking activities, and those of other multi-bank holding companies, as a means by which the commercial banking power of these holding companies

[21]*See, e.g.*, 102 *Cong. Rec.* 6,943 (1956) (statement of Sen. Morse) (bill "primarily aimed" at Transamerica); H. R. Rep. No. 609, 84th Cong., 1st Sess. 9, 17 (1955) (Transamerica a "concrete illustration" of the potential abuses arising out of bank holding companies with large banking assets).

might be enhanced, to the detriment of independent banks.[22] The Act was described in congressional reports not as an effort to separate banking and commerce but as a bill to promote fair competition and prevent the abuse of commercial credit power.[23]

As enacted, the BHCA covered only companies that owned two or more "banks," a term which was defined broadly to include any institution chartered as a bank under federal or state law. The scope of the BHCA was sharply limited by the multi-bank requirement, and by a number of significant exemptions that removed several large multi-bank holding companies from its coverage. Thus, of the 163 companies that owned at least one bank in 1956, only 44 were multi-bank holding companies subject to the Act. Of these 44 multi-bank holding companies, many were exempted entirely from the Act, and it appears that only six, including most notably Transamerica, were required to divest those nonbanking businesses that did not conform to statutory requirements.[24]

[22]For example, in opposing an amendment that would have allowed multi-bank holding companies to continue to hold all of their nonbanking assets, Senator Robertson stated:

> The very object of the independent bankers would be defeated, which is to break up the combination between banking assets, on the one hand, and a vast industrial expansion on the other, where the overlord, the holding company, can pump assets into one branch or bank to stifle competition, against the interest of the local people.

102 *Cong. Rec.* 6,920 (1956).

See also 102 *Cong. Rec.* 6,861-62 (1956) (statement of Sen. Payne) (vast capital resources behind a subsidiary bank an "undeniable competitive advantage" against independent banks).

[23]*See, e.g.*, H.R. Rep. No. 609, *supra* note 22, at 2-6 (describing the "four fundamental reasons" for enacting the legislation: (i) preventing concentration of banking resources, (ii) stopping circumvention of state laws against interstate banking, (iii) preventing potential abuses of credit powers, and (iv) fostering competitive banking).

[24]*See* Note, *The Bank Holding Company Act of 1956*, 9 Stan. L. Rev. 333, 347-48 (1957).

Because it applied only to multi-bank holding companies, the BHCA as initially adopted did not separate banking and commerce. Of the 119 one-bank holding companies that were not covered by the Act, many were diversified commercial firms that owned a single bank.[25] The Board protested this exclusion, arguing for a true separation of banking and commerce, but the Senate Banking Committee could find no reason to take this step. *See* S. Rep. No. 1095, *supra* note 10, at 7. On the contrary, Congress was concerned that including one-bank holding companies would probably result in the forced sale of large numbers of small banks and therefore in the diminution of competition.[26]

The real focus of congressional concern was the concentration of commercial credit power in multi-bank holding companies and not the abstract concept of separating banking and commerce. The Senate Committee Report made this clear:

> Your committee did not deem it necessary to include within the scope of this bill any company which manages or controls no more than a single bank. It is possible to conjure up visions of monopolistic control of banking in a given area through ownership of a single bank with many and widespread branches. However, in the opinion of your committee, no present danger of such control through the bank holding company device threatens to a degree sufficient to warrant inclusion of such a company within the scope of this bill.

[25]One hundred and sixty-three bank holding companies existed as of 1956, many with large nonbanking businesses. Among those which continued to be exempt from federal regulation after the Act were W. R. Grace & Co., Deere & Co., Corn Products Refining Co., Gimbel Bros., Inc., and Equity Corp. (which owned Bell Aircraft Corp., four other industrial corporations, a real-estate company, and an oil company). *See* 102 *Cong. Rec.* 6,942 (1956) (statement of Sen. Morse). *See generally Control of Bank Holding Companies: Hearings Before a Subcommittee of the Senate Committee on Banking and Currency on S. 850, S. 2350, and H.R. 6276*, 84th Cong., 1st Sess. 51-60 (1955) (listing all bank holding companies as of that time).

[26]*See* Chase, *The Emerging Financial Conglomerate: Liberization of the Bank Holding Company Act*, 60 Geo L.J. 1225, 1232-33 (1972).

S. Rep. No. 1095, *supra* note 10, at 7.

C. 1966 Amendments

The passage of the BHCA did not diminish the Board's enthusiasm for expanding its regulatory authority to *all* holding companies of depository institutions, and it continued its campaign under the banner of separating banking and commerce.[27]

Congress ignored the Board's requests for more authority until 1966. In hearings on bills to amend the 1956 Act, the Board's then Chairman, William McChesney Martin, Jr., advocated that the BHCA be extended to one-bank holding companies in order to effect the separation of banks from nonbanking businesses:

> The first [objective of the BHCA] is to prevent undue concentration of control over banks in the hands of any holding company, and the second is to prevent any holding company from controlling both banks and nonbanking businesses . . . . While there would obviously be no need for the act to cover one bank holding companies if its only purpose were to prevent any holding company from acquiring too many banks it seems just as clear that coverage of one bank holding companies is necessary to accomplish the act's second objective.

Amend the Bank Holding Company Act of 1956: Hearings, *supra* note 11, at 58.

Congress, however, had much more limited objectives in mind. The 1966 amendments merely refined the BHCA as

[27]On May 7, 1958, for example, it filed a special report with Congress which recommended, among other things, both the extension of the 1956 Act to one-bank holding companies and the repeal of some of the exemptions adopted in 1956. *See Report of the Board of Governors of the Federal Reserve System Pursuant to the Bank Holding Company Act of 1956* 8-15 (1958). *See generally* Savage, *A History of the Bank Holding Company Movement, 1900-78*, in Staff of the Board of Governors of the Federal Reserve System, *The Bank Holding Company Movement to 1978: A Compendium* 21, 51-52.

passed a decade earlier.[28] Congress again refused to adopt the Board's request that the Act be extended to one-bank holding companies. The Senate Banking Committee noted that the Board's approach might diminish rather than increase competition:

> [T]here was no substantial evidence of abuses occurring in one-bank holding companies. Furthermore, the committee received much testimony to the effect that repeal of the exemption would make it more difficult for individuals to continue to hold or to form small independent banks. The repeal of the exemptions would, therefore, be likely to result in causing the forced sale of large numbers of banks and in a diminution of competition rather than in an increase of competition. Consequently, the committee decided not to adopt this proposal.

S. Rep. No. 1179, *supra* note 6, at 5.

Significantly, and wholly consistent with the Act's purpose, Congress also used the occasion of the 1966 amendments to narrow the definition of "bank" so that the BHCA unambiguously applied only to *commercial* banks. The context of this action demonstrates clearly that Congress intended to reserve to itself the authority to extend the BHCA to other classes of depository institutions.

As initially adopted, the Act covered the holding companies of two or more "banks," defined as "any national banking organization or any State bank, savings bank, or trust company." Ch. 240 at § 2(c), 70 Stat. 133 (1956). In 1963, the Board attempted to place a functional ("actual practice") construction on this language. Although the Board admitted that the BHCA was intended to cover only commercial banks, 49 Fed. Res. Bull.

[28] Among the major changes were the elimination of the 1956 Act's exemption for charitable trusts—thus permitting coverage of the Alfred I. duPont Trust, which owned or controlled 30 banks in Florida, *see* S.Rep. No. 1179, *supra* note 6, at 3-4—and the elimination of provisions in the 1956 Act which had restricted loans by a holding company bank to its affiliates. *See id.* at 10.

166 (1963), it sought to include industrial banks under the Act if:

> in a particular case, regardless of the title of the institution or the form of the transaction, it *accepts deposits subject to check or otherwise accepts funds from the public that are, in actual practice, repaid on demand*, as are demand or savings deposits held by commercial banks.

Id. (emphasis added).

Responding in 1966 to the ensuing protests of the industrial bank industry, Congress not only corrected this erroneous interpolation of its 1956 language but also rejected compromise language advanced by the Board that would have defined "bank" for purposes of the BHCA as any institution that accepts deposits "payable on demand." This malleable phrase would have left the issue of the Board's jurisdiction unresolved. The Board suggests in its brief that it proposed the change in language that Congress eventually adopted in 1966, but this is not the case.[29] Nor is it accurate to say, as the Board states in its brief, that "[t]he Board's proposal was in substance enacted." Pet. Br. at 29.

Indeed, Congress rejected any form of words that might confer on the Board the latitude to expand the scope of the language of Congress, and did this by including in the 1966 amendments a new and narrower definition of bank that focused entirely on the *legal rights* of the depositor. The new definition, which was supplemented but not changed by the 1970 amendments, defined a "bank" for purposes of the BHCA as "any institution that accepts deposits that the depositor has the legal right to withdraw on demand." Pub.L. No. 89-485, § 2(c), 80 Stat. 236 (1966).

[29] The Board implies, Pet. Br. at 29, that it submitted compromise statutory language that included "checking accounts" as the defining element of a demand deposit. However, in reality, the Board's proposed statutory language referred only to "deposits payable on demand" and made no reference to checking accounts. Letter of J. L. Robertson, (April 20, 1966), *reprinted in Amend the Bank Holding Company Act; Hearings supra* note 11, at 447.

Thus, Congress rejected the Board's "functional" reconstruction of its 1956 language and substituted a definition that acquired precision through its focus on the legal rights of the depositor. Whether a depositor has a legal right to withdraw his deposit on demand, of course, may be ascertained with specificity. As such, any latitude the Board might have had to place an "actual practice" interpretation on this language was eliminated.

In the matter now before this Court, however, the Board has again attempted to interpolate an "actual practice" standard into a specific congressional formulation. This time, the Board contends that NOW accounts are the "functional equivalent" of "deposits that the depositor has the legal right to withdraw on demand" because in "actual practice" depository institutions do not exercise their own reserved right to reject such a demand withdrawal. Pet. Br. at 33. But this effort to read a functional equivalence concept into language chosen for its legal specificity clearly evades the purpose of Congress.

Moreover, although the Board attempts, Pet. Br. at 28-29, to minimize the significance of its reversal by Congress in 1966, the legislative history demonstrates that Congress chose to redefine bank as it did because it wanted to leave no latitude for the Board to expand the BHCA to the corporate owners of depository institutions other than commercial banks. The Senate Report on the 1966 amendments sheds light not only on the demand deposit language but also on the purposes of the BHCA as a whole:

> *The purpose of the act was to restrain undue concentration of control of commercial bank credit, and to prevent abuse by a holding company of its control over this type of credit for the benefit of its nonbanking subsidiaries.* This objective can be achieved without applying the act to savings banks, and there are at least a few instances in which the reference to "savings bank" in the present definition may result in covering companies that control two or more industrial banks. To avoid this result the bill redefines "bank" as an institution that accepts deposits payable on demand (checking accounts), *the commonly accepted test of whether an institution is a commercial bank* so as to exclude *institutions like* industrial banks and nondeposit trust companies.

S. Rep. No. 1179, *supra* note 6, at 7 (emphasis added).

Congress could not have been more direct: the purpose of the BHCA was to control commercial banks. Institutions that were not commercial banks were not to be covered; in order to be sure that *only* commercial banks *were* covered, these institutions were defined with reference to their distinguishing feature — the acceptance of demand deposits that the depositor has a legal right to withdraw on demand.

Thus, Congress did not adopt the demand deposit formulation in 1966 in order to cover all institutions that offered accounts accessible by check, but as a short-hand method of defining commercial banks, the only institutions intended to be subject to the BHCA.

D. 1970 Amendments

1. Application of the BHCA to One-Bank Holding Companies

Not long after Congress affirmed the exclusion of one-bank holding companies in 1966, the courts rejected various rulings by the Comptroller of the Currency that had permitted expanded banking-related activities by national banks.[30] Large commercial banks began turning to one-bank holding companies as vehicles for extending their activities into related fields.[31] The significance of the one-bank holding company form

[30] *See, e.g., Saxon v. Georgia Ass'n of Indep. Ins. Agents*, 399 F.2d 1010 (5th Cir. 1968) (Comptroller did not have the authority to allow national banks to act as insurance agents in locations exceeding 5,000 in population). *See also* Comment, *Implementation of the Bank Holding Company Act Amendments of 1970: The Scope of Banking Activities*, 71 Mich. L. Rev. 1170, 1173-76 (1973) (discussing frustration of Comptroller's efforts).

[31] *See, e.g.*, Chase, *The Emerging Financial Conglomerate: Liberalization of the Bank Holding Company Act*, 60 Geo.L.J. 1225, 1234, (1972) ("dramatic proliferation" of one-bank holding companies due, in part, to bankers' efforts to broaden their services through this more flexible corporate form).

thus changed dramatically. Nearly 900 new one-bank holding companies were created between 1965 and 1970, and the percentage of the nation's total banking deposits controlled by one-bank holding companies grew from less than 10% in early 1967 to more than 40% in 1969. Most significantly for Congress, the six largest commercial banks in the country, which cumulatively held more than 20% of the country's deposits, each formed a one-bank holding company during this period. S. Rep. No. 1084, *supra* note 6, at 2-3.

The increase in the use of the one-bank holding company by large commercial banks led to a concern in Congress that the rapid expansion of this corporate structure could lead to excessive concentration of commercial credit power as clusters of large commercial enterprises formed around large commercial banks. The 1970 amendments to the BHCA ensued. Although the Administration and the House Banking Committee each developed a bill, the Senate bill was substantially the version ultimately adopted.[32]

The congressional purpose behind the measure was articulated as follows by Senator Harrison Williams, a member of the Senate Banking Committee:

> The creation of large bank-originated one-bank holding companies is the sole reason for the legislation before us today. Businessmen fear disabling competition caused by large banks with their vast economic resources. Various proposals have been advanced to bring these banks under the regulatory framework. This is the purpose of . . . the Bank Holding Company Act amendments of 1970.

116 *Cong. Rec.* 32,107 (1970).

But concern about the power of the large commercial banks did not cause Congress to adopt the Board's theory that banking and commerce should be separated. When Congress brought one-bank holding companies under the BHCA, it took steps in the interest of preserving and extending competition

[32]*See, e.g.*, 116 *Cong. Rec.* 41,953 (1970) (statement of Rep. Widnall).

to assure that these firms were permitted to *expand* their commercial activities, although to a limited degree. Prior to 1970, the Board had limited the activities of each bank holding company to those businesses that were directly related to the activities of its particular subsidiary banks. The 1970 Amendments made important changes in the Board's authority under section 4(c)(8) of the Act that were intended to free the Board from these narrow precedents.

Far from separating banking and commerce, the principal congressional proponents of the 1970 amendments[33], commentators,[34] and even the Board, expected that these changes in the language of the BHCA would enable bank holding companies to expand their activities into areas of commerce "closely related to banking" but nevertheless not permissible to banks themselves.[35] In the words of Senator Sparkman (the Chairman of the Senate Banking Committee and the principal Senate conferee):

> The bill [agreed upon in conference] . . . provided the necessary flexibility of regulation and administration which the Federal Reserve Board requested in order to permit it to depart from past precedents and to permit expansion of bank and bank related activities which will be required in order to meet fully the rapidly expanding and varying financial needs of the economy of the Nation.

[33]Although the House managers of the bill interpreted the changed language in § 4(c)(8) to be more restrictive, *see* Statement of the Managers on the Part of the House, H.R. Rep. No. 1747, 91st Cong., 2d Sess. 11, 21–22 (1970), the Senate conferees, a minority of the House conferees, and the Board believed that the changes considerably expanded the latitude for bank holding companies to engage in non-banking activities. *See, e.g.*, 116 *Cong. Rec.* 42,422 (1970) (statement of Sen. Sparkman); 116 Cong. Rec. 41,953 (1970) (statement by Rep. Widnall); letter of Chairman of the Board of Governors Arthur Burns *reprinted in* H.R. Rep. No. 1747, *supra*, at 16.

[34]*See* Chase, *supra* note 26, at 1247.

[35]*See National Courier Ass'n v. Board of Governors of the Fed. Reserve Sys.*, 516 F.2d 1229, 1236 (D.C. Cir. 1975) (1970 amendments give Board greater discretion to permit bank holding companies to engage in nonbanking activities).

116 *Cong. Rec.* 42,422 (1970).

Arthur Burns, then the Board's Chairman, joined in support of the conference language:

> [W]e do not believe it is desirable to unduly restrict entry by nonbank subsidiaries into markets that are distinct from those served by the subsidiary banks of the holding company.

Letter to Chairman of the House Banking Committee, (Nov. 23, 1970), *reprinted in* 116 *Cong. Rec.* 42,423 (1970).

The Board itself moved quickly to permit regulated bank holding companies to enter areas of commerce ordinarily denied to banks.[36]

Thus, while Congress applied the BHCA to one-bank holding companies in 1970, it sought at the same time to enhance competition by permitting these institutions to enter new commercial activities, "closely related to banking" as defined by the Board. The fact that these new activities were to be limited in scope is consistent with a view of the BHCA as a statute intended to curb the economic power of commercial banks, and not to implement a policy of separating banking and commerce.

2. Definition of "Bank"

Returning again to its 1966 language (which defined "bank" as an institution that "accepts deposits that the depositor has a legal right to withdraw on demand"), Congress in 1970 added the further test "and engages in the business of making commercial loans."[37] The addition of a commercial loan requirement to language that Congress had carefully chosen in 1966 as a

[36]*See* Reg. Y, 36 Fed. Reg. 15,526 (1971). Today, such permissible activities include, *inter alia*, data processing services, underwriting credit life, accident and health insurance, courier services, management consulting, issuance and sale of savings bonds and travelers checks, real estate, appraisal, and acting as a futures commission merchant. *See* 12 C.F.R. § 225.25, 49 Fed. Reg. 826-28 (Jan. 5, 1984).

[37]Pub. L. No. 91-607, § 101(c), 84 Stat. 1760, 1762, 12 U.S.C. § 1841(c) (1970).

precise legal definition of commercial banking underscores a congressional purpose to apply the Act to a particular aspect of commercial banking.

The commercial loan requirement first appeared as part of a comprehensive bill to amend the BHCA, introduced in 1970 by Senator Edward Brooke of Massachusetts. 116 *Cong. Rec.* 14,818-22 (1970). The Board's brief completely misstates the facts of Senator Brooke's involvement in the debate over the 1970 amendments, implying incorrectly that Senator Brooke introduced only the commercial loan proviso and did so "without discussion or comment." Pet. Br. at 41.

In fact, the commercial loan proviso was part of a thoroughgoing reform bill, S. 3823, by which Senator Brooke proposed to eliminate the restrictions on nonbanking activities of a bank holding company if the holding company's subsidiary banks had no dealings with the customers or suppliers of their nonbanking affiliates. *See* S. 3823 at § 3. Senator Brooke explained that this would eliminate the possibility that commercial banks would misuse their commercial credit power to assist their holding company affiliates. *See* 116 *Cong. Rec.* 14,820 (1970) (statement of Sen. Brooke). The bill also contained special anti-tying provisions, which were intended to prevent a commercial bank's use of its credit granting powers to coerce customers into dealing with its nonbanking holding company affiliates. *See* S. 3823 at § 4. Thus, it was fundamental to Senator Brooke's proposal that commercial loans be understood to mean loans negotiated between a bank and a customer. Only in that case would it be possible for a commercial bank to favor its affiliates, and only in that case would anti-tying provisions be necessary.

Far from advancing his proposal "without discussion or comment," Senator Brooke's bill was accompanied by an extensive statement. 116 *Cong. Rec.* 14,818-22 (1970). As a member of the Senate Banking Committee, Brooke took an active part in hearings on the 1970 amendments and the floor debates.[38]

[38]*See, e.g., One-Bank Holding Company Legislation of 1970: Hearings on S. 1052, S. 1211, S. 1664, S. 3823 and H.R. 6778, Before the Senate Committee on Banking and Currency,* 91st Cong., 2d Sess. 150-51 (1970); 116 *Cong. Rec.* 32,127-33 (1970) (statements of Sen. Brooke).

Indeed, Senator Brooke's bill had considerable influence on the Senate bill ultimately reported out in September of 1970. His definition of "bank" was adopted by the Senate Banking Committee along with the anti-tying language he had also included in S.3823. *Compare* § 4 of S. 3823 *with* § 106 of Pub.L. No. 91-607 (1970). The Committee's report clearly adopted Senator Brooke's approach:

> The definition of "bank" adopted by Congress in 1966 was designed to include commercial banks and *exclude those institutions not engaged in commercial banking*, since the purpose of the Act was *to restrain undue concentration of commercial banking* resources and to *prevent possible abuses related to control of commercial credit*. However, the Federal Reserve Board has noted that this definition may be too broad and may include institutions *which are not in fact engaged in the business of commercial banking in that they do not make commercial loans*. The Committee, accordingly, adopted a provision which would exclude institutions that are not engaged in the business of making commercial loans from the definition of "bank."

S. Rep. No. 1084, *supra* note 6, at 24 (emphasis added).[39]

Moreover, it is highly significant to the issue now before this Court that Senator Brooke's language concerning commercial

[39]The Board asserts in its brief, without any support whatsoever, that the commercial loan proviso inserted in the 1970 amendments was "a technical amendment designed to create a narrowly circumscribed exclusion from the Act's coverage," Pet. Br. at 41, and implies, *id.* at 13 and 43, that the definition of "bank" proposed by S. 3823 was intended only to cover a single institution in Massachusetts — the parent of the Boston Safe Deposit and Trust Company ("Boston Safe"), a largely trust-service institution that also accepted demand deposits.

This hypothesis is inherently unrealistic and does not reflect the legislative history of the 1970 amendments. Although Senator Brooke's definition certainly had the effect of excluding Boston Safe from the BHCA, it was intended to do much more. If Senator Brooke had intended solely to exempt Boston Safe from the Act he would not have introduced and consistently argued for a comprehensive bill; all that would have been necessary to achieve this narrower purpose was, *e.g.*, an exemption for trust companies that accepted demand deposits incidental to their trust activities.

loans was intended to cover commercial lending in the traditional, accepted sense, *i.e.*, a bank's making commercial credit available to a customer in a negotiated transaction that could involve tying or other abuses. In its brief, the Board itself describes potential "abuses" of commercial credit, such as preferential allocation of credit. *See* Pet. Br. at 21. These abuses can occur only when a commercial bank makes a loan directly to a particular customer,[40] and they do not arise when a bank purchases money market instruments in the open market. That Congress held the same view is demonstrated by the reference in the Senate Report to "possible abuses related to control of commercial credit." S. Rep. No. 1084, *supra* note 6, at 24.

Much as it has done with its analysis of NOW accounts, *see* Pet. Br. at 26-38, the Board has based the regulatory reversal challenged in this case on a tortured "functional" reconstruction of what Congress meant by "the business of making commercial loans." Once again the Board asserts that an activity Congress did not mention is functionally equivalent to or otherwise the same as something to which Congress did specifically refer. Thus, the Board advances the proposition that a bank's transactions in the money market, such as purchasing commercial paper, bankers' acceptances and certificates of deposit, are a "permissible construction" of the term "commercial loan." Pet. Br. at 39. But Senator Brooke's use of the term commercial loan, and the use clearly contemplated by Congress at the time, was a more limited and customary definition. Indeed, the Board itself implemented this definition for many years,[41] only

[40]Indeed, in a 1966 letter to Sen. Robertson, the Board's Chairman, indicated his support for language limiting the BHCA soley to banks that make commercial loans: "I am impressed by the argument that a bank that does not make commercial loans is not apt to be involved in the kind of abuses the Act is designed to prevent." *Reprinted in* 112 *Cong. Rec.* 12,386 (1966).

[41]Until 1982, the Board's test for defining "commercial loan" distinguished between "passive" media of investment and the close "lender-borrower relationship that is one of the characteristics of commercial loans, and which presents the possiblity of abuses relating to the control of commercial credit that concerned the Congress when it adopted the commercial lending test found in the Act." Letter to William McDonough, Ass't. General Counsel, Federal Reserve Bank of Boston, from Robert E. Minton, Deputy General Counsel, at 2 (November 13, 1980) (J. A. 105A).

reversing its interpretation when it sought a basis for inhibiting the development of non-BHCA banks.

Thus, the 1970 Amendments to the BHCA clearly follow the pattern established in 1956 and 1966. The Act was modified to address a new manifestation of the economic power of large commercial banks. To avoid excessive restrictions on competition, Congress sought to *expand* the range of commercial activities permitted to regulated bank holding companies newly brought under the BHCA. Congress also amended the definition of "bank" to emphasize that while the BHCA was intended to apply to commercial banks, it was the potential abuses inherent in a commercial bank's relationship with its loan customers, such as tying, that were of particular concern.

Thus, the Board's efforts to expand the concept of "commercial loan" in Regulation Y, and to support its revisions of Regulation Y with generalizations concerning the separation of banking and commerce, are inconsistent with the Amendments to the BHCA adopted by Congress in 1970.

E. Congressional Action after 1970

The actions of Congress in the Garn-St Germain Depository Institutions Act of 1982 ("Garn-St Germain"), underscores the fact that Congress has never adopted a policy of separating banking and commerce.

In Garn-St Germain, all federally chartered savings and loan associations and federal savings banks were for the first time given authority to make commercial loans up to 10% of their assets, *See* Pub. L. No. 97-320, § 325, and to establish demand accounts for commercial customers with which they have established a commercial loan relationship. *Id.*, § 312.

The combination of commercial lending and demand deposit powers brought these thrift institutions squarely within the definition of "bank" under the BHCA and would have subjected their holding companies to the strictures of the BHCA. If, as the Board suggests, Congress had adopted and intended to pursue a national policy of separating banking and commerce, this is exactly the result one would have expected. But Con-

gress has been concerned about the enhancement of the economic power that inheres in the concentration of commercial credit resources, not about the separation of banking and commerce. Because thrift institutions offered no significant threat of monopolizing commercial credit, Congress saw no reason to subject them to the regime of the BHCA, even though they were now able to exercise (to a limited degree) all of the powers of commercial banks. Thus, in Section 333 of Garn-St Germain, 12 U.S.C. § 1841(c), Congress exempted a whole class of thrifts from the BHCA[42], permitting their holding companies to be regulated solely under the Savings and Loan Holding Company Act, 12 U.S.C. § 1730a, which imposes no restrictions on the holding companies of a single thrift institution.[43]

It is also particularly instructive for this case that Congress chose in Garn-St Germain to link commercial lending and demand accounts. In 1980, savings and loans had been authorized to offer NOW accounts to individuals. Depository Institutions Deregulation and Monetary Control Act of 1980, Pub. L. No. 96-221, § 303, 94 Stat. 132, 146, 12 U.S.C. § 1832(a). In Garn-St Germain, rather than extend NOW accounts to commercial customers of thrifts, Congress authorized demand accounts for these customers. That choice demonstrates that Congress understands the difference between demand accounts and NOW

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[42]Under Garn-St Germain, the exemption from the BHCA is effective if the thrift institution qualifies as a domestic building and loan association under Section 7701(a)(19) of the Internal Revenue Code of 1954, 26 U.S.C. § 7701(a)(19). Generally, at least 60% of the assets of a qualifying domestic building and loan association must consist of cash, residential mortgage loans, time and demand deposits with financial institutions, obligations of the United States or political subdivisions, educational loans and other specified instruments.

[43]As Congress was aware when granting commercial lending authority to thrifts in 1982, commercial companies had long owned savings and loan associations. Indeed, Sears, Roebuck and Co. has been a savings and loan holding company for over 25 years by virtue of its control of an insured institution in California. The Ford Motor Company recently announced that it intends to acquire First Nationwide Federal Savings & Loan Association, one of the nation's largest thrift institutions. *See* Am. Banker, Aug. 2, 1985, at 1, col. 4.

accounts and does not use these terms interchangeably in legislation.

CONCLUSION

For decades, the Federal Reserve Board has sought to extend its authority over the holding companies of the nation's depository institutions. Its central theme has been the "separation of banking and commerce." The Board has urged this policy on Congress so often and so persistently that the Board seems actually to believe that such a policy has been adopted.

Congress, on the other hand, has been equally persistent in avoiding the establishment or implementation of an overarching and inflexible "principle" such as separating banking and commerce. Instead, it has sought simply to restrain the economic power of commercial banks, acting to deal with each specific manifestation of this power as it arose, and going no further than necessary to achieve its limited objectives. Thus, despite recurring demands by the Board, Congress has been moved to address bank holding companies only in response to external events that were widely perceived to portend major enhancements of the economic power of commercial banks. Examples include the denial of the Board's Clayton Act prosecution against Transamerica Corporation in 1953 and the rapid movement of large commercial banks into one-bank holding companies after 1968.

Particularly since 1980, the Board has repeatedly stressed the urgency of enacting legislation that would bring non-BHCA banks under the Act. Congress has remained unmoved. Impatient to achieve its ends, however, and pursuing its own vision of how the financial services system should be organized and regulated, the Board has attempted in the regulatory action challenged in this case to arrest the development of non-BHCA banks. In order to reach institutions that it now regards as undesirable, the Board has unilaterally attempted to expand its own authority without the participation of the Branches of Government created by Articles I and II of the Constitution and it has done so once again by placing its own unauthorized

gloss on statutory language carefully chosen by Congress for its specificity and precision.

The high-sounding cloak for this usurpatory action is a mythic "national policy" of separating banking and commerce. This Court should not lend its imprimatur to a policy that the Board alone has adopted, or to the unauthorized regulation issued in its name.

For these reasons, this Court should affirm the decision of the court below.

Respectfully submitted,

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No. 84-1274

IN THE
Supreme Court of the United States

OCTOBER TERM, 1985

BOARD OF GOVERNORS OF THE
FEDERAL RESERVE SYSTEM,
Petitioner,
v.
DIMENSION FINANCIAL CORPORATION, *et al.*,
Respondents.

On Writ of Certiorari to the United States Court of Appeals for the Tenth Circuit

BRIEF OF INDEPENDENT BANKERS ASSOCIATION OF AMERICA AMICUS CURIAE IN SUPPORT OF PETITIONER

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BRIEF OF INDEPENDENT BANKERS ASSOCIATION OF AMERICA AMICUS CURIAE IN SUPPORT OF PETITIONER

The Independent Bankers Association of America ("IBAA") appears herein as *amicus curiae* pursuant to Supreme Court Rule 36.2. All parties have consented in writing to IBAA's participation as *amicus curiae* and to the filing of this brief.

I
QUESTION PRESENTED

The IBAA adopts the Question Presented set forth in the Brief of the Board of Governors of the Federal Reserve System (the "Board").

II
STATEMENT OF THE CASE

The IBAA adopts the Statement of the Case presented by the Board.

III
INTEREST OF AMICUS CURIAE

The IBAA is a Minnesota non-profit corporation with headquarters in Washington, D.C. and offices in Sauk Centre, Minnesota. The IBAA represents over 7,400 commercial banks in 49 states and the District of Columbia, roughly half of all the banks in the United States. IBAA is committed to maintaining the principle that individual states have the right and responsibility to determine the structure of banking within their borders. This principle is embodied both in section 36 of the National Bank Act (the "McFadden Act"), 12 U.S.C. § 36, and section 3(d) of the Bank Holding Company Act of 1956, as amended, (the "Douglas Amendment"), 12 U.S.C. § 1842(d). IBAA further supports continued maintenance of the Congressionally mandated separation of banking from the activities of non-banking organizations as vital to the safety and soundness of the nation's banking system. IBAA has appeared as a party and as *amicus curiae* on numerous occasions in court actions and administrative proceedings relating to the preservation of these principles.

IBAA is currently a plaintiff in *IBAA, et al. v. Conover*, No. 84-1403-CIV-J-12, now pending before the United States District Court for the Middle District of Florida. In that case IBAA has challenged the authority of the Comptroller of the Currency of the United States, under the National Bank Act, to grant national bank charters to so-called "nonbank banks", because charter applicants for such institutions represent that

they will not engage in one or the other of the two traditional activities of commercial banking—the acceptance of demand deposits and the making of commercial loans. IBAA has alleged that the National Bank Act does not authorize the chartering of such institutions and that the sole purpose of their structure is to evade the definition of "bank" in the Bank Holding Company Act of 1956, as amended, 12 U.S.C. § 1841 ("BHCA" or the "Act"). Nonbank banks hope to avoid the jurisdiction of the Board and the BHCA's prohibitions against interstate ownership of banks and ownership by nonbanking organizations. On February 15, 1985, the Court granted IBAA's motion for preliminary injunction and enjoined the Comptroller from issuing final approvals for nonbank bank charters pending a decision on the merits.

IV
ARGUMENT

It is submitted that organizations which offer both demand deposit and commercial lending services or, as amended Regulation Y provides, NOW accounts in lieu of checking accounts, and any type of loans other than personal loans, were intended by Congress to be included within the scope of the provisions of the BHCA and subject to Board jurisdiction.

The Board's revised Regulation Y, 12 C.F.R. § 225.2(a)(1)(A) & (B), interprets the definition of "bank" as set forth in the BHCA[1] to include services proposed to be offered by a growing

[1]12 U.S.C. § 1841(c) defines "bank" as any institution which "(1) accepts deposits that the depositor has a legal right to withdraw on demand, and (2) engages in the business of making commercial loans."

Revised Regulation Y provides further detail regarding the statutory definition:

> For the purposes of this definition:
>
> (A) "Deposits that the depositor has a legal right to withdraw on demand" (hereinafter "demand deposits") means any deposit with transactional capability that, as a matter of practice, is payable on demand and that is withdrawable by check, draft,

number of nonbank banks that would otherwise have expected to escape Board regulation as "banks" under the BHCA by relying on a strictly technical reading of the section 1841(c) definition. As amended, Regulation Y includes as "banks" for purposes of the Act those institutions which both offer NOW accounts and make commercial loans, and those which both purchase short-term commercial obligations and offer checking accounts. The Board's interpretation thus brings the parent companies of such institutions within the jurisdiction of the Board and the regulations and restrictions imposed by the BHCA.

The Respondents, Dimension Financial Corp., *et al.*, have challenged the Regulation Y amendments on the grounds that: (1) The regulation is inconsistent with the letter and purpose of the BHCA; (2) the Board exceeded its authority in issuing its amended interpretation of the definition of "bank" in the BHCA; and (3) the Board failed to satisfy the rulemaking requirements of the Administrative Procedure Act, 5 U.S.C. § 553.

It is the position of IBAA that the Board acted well within the scope of its statutory supervisory authority and its administrative discretion to construe the Act so as to apply its coverage to financial institutions that are substantively within the meaning and intent of the provisions of the BHCA. Indeed, the Board's action was essential to protect the integrity of the BHCA and the existing structure of bank regulation from a

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negotiable order of withdrawal, or other similar instrument; and

(B) "Commercial loans" means any loan other than a loan to an individual for personal, family, household, or charitable purposes, and includes the purchase of retail installment loans or commercial paper, certificates of deposit, bankers acceptances, and similar money market instruments, the extension of broker call loans, the sale of federal funds, and the deposit of interest-bearing funds.

12 C.F.R. § 225.2(a)(1).

wholesale evasion of the Act through the use of the nonbank device.

A. Congressional Intent is the Overriding Consideration in Construing the Bank Holding Company Act.

The U.S. Court of Appeals for the Tenth Circuit below relied on an overly narrow construction of "demand deposit" and "commercial loan" in holding that the Board lacked the authority to amend Regulation Y by expanding those definitions. *See Dimension Financial Corp. v. Board of Governors of the Federal Reserve System*, 744 F.2d 1402 (10th Cir. 1984), *cert. granted*, ___ U.S. ___, 105 S. Ct. 2137 (1985). If upheld, this formalistic approach would render the Board incapable of discharging its responsibilities under the BHCA to prevent, among other things, the concentration of banking resources through strict enforcement of the Act's limitations on interstate banking and on commingling of banking and non-banking activities.

The Tenth Circuit invalidated the Board's expanded definition of "demand deposit" solely on the strength of its own earlier decision in *First Bancorporation v. Board of Governors of the Federal Reserve System*, 728 F.2d 434 (10th Cir. 1984) (the *Beehive* case), without further discussion. *See* 744 F.2d at 1404, 1411.[2] In *Beehive* the court ruled that since the state law required that industrial loan companies reserve the right to require notice prior to withdrawal from NOW accounts, customers had no legal right to withdraw funds on "demand" and thus NOW accounts were not "demand deposits" under the BHCA. 728 F.2d at 436. This conclusion was reached despite the court's acknowledgment that withdrawals from NOW accounts were in actual practice permitted on demand. *See id.*

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[2]In *Beehive*, the court overturned a determination by the Board that an industrial loan company that offered negotiable order of withdrawal ("NOW") accounts would be subject to the reserve and interest limitations applicable to "banks" under the BHCA. The *Beehive* court rested its decision on a strict construction of 12 U.S.C. § 1841(c). 728 F.2d at 436.

Addressing the second prong of the "bank" definition as interpreted in the Board's revised Regulation Y in this case, the Tenth Circuit invalidated the amendment on the ground that the expanded definition of "commercial loan" represented a "complete 'reversal'" of the previously accepted meaning of that term, 744 F.2d at 1404, although the court was unable to point to any statutory authority or legislative history that provided a contrary interpretation of the meaning of commercial loan.[3]

1. Overwhelming Case Precedent Compels the Board to Elevate Substance Over Form.

In adopting a very literal approach to the meaning of "demand deposit" and "commercial loan" under the BHCA, the Tenth Circuit completely ignored—or subordinated—both express Congressional intent in enacting the BHCA and the purposes underlying the deliberate scheme of federal regulation of commercial banking. It is well established, however, that the courts may not exalt form over substance when to do so would subvert Congressional intent.

This specific principle was forcefully articulated by this Court under very similar circumstances in *First National Bank in Plant City, Florida v. Dickinson*, 396 U.S. 122 (1969).

[3]The court referred to several isolated Board letters and internal memoranda that had excepted particular transactions from the purview of "commercial loans" under the Act and that appeared to conflict with the Board's current interpretation. 744 F.2d at 1405-06. The court admitted, however, that the Board had already applied the broader definition, later embodied in Regulation Y, in the case of the Dreyfus Letter (December 1982). *Id.* at 1406.

Further, the Board established that it had previously maintained a consistent policy since 1971 of treating as commercial loans "all loans other than a loan the proceeds of which are used to acquire property or services used by the borrower for his own personal, family, or household purposes, or for charitable purposes." *See* Bank Holding Companies and Change in Bank Control; Revision of Regulation Y, Supplementary Information, Appendix A, 49 Fed. Reg. 833, 842 (Jan. 5, 1984) (hereinafter referred to as "Regulation Y, Supplementary Information").

The Court held that an armored car service and shopping center depository receptacles used to collect customer deposits were "branches" within the meaning and intent of the definition of "branch" bank in the McFadden Act, and thus prohibited by a Florida law outlawing branch banking. Despite the scrupulous efforts of First National Bank to draft contracts with its customers to avoid the literal language of the branch definition and thereby avoid treatment of these facilities as "branches", the Court held:

> Here, penetrating the form of the contracts to the underlying substance of the transaction, we are satisfied that . . . the bank has, for all purposes contemplated by Congress . . ., received a deposit.

Id. at 137. The Court stressed that a major objective of the federal system of bank regulation is the maintenance of "competitive equality" between federal and state-chartered institutions. The Court ruled that Congress could not have intended a device designed to give a competitive advantage to national banks by evading the restrictions contained in federal regulation (here, the McFadden Act's prohibition on branch banking except as permitted to state chartered banks under state law) to escape regulation. *Id.* at 136-37.

The circuit courts have consistently applied the reasoning in *Plant City* to eliminate other similar devices especially designed to escape restrictions of the BHCA and the National Bank Act. Most recently in *Florida Department of Banking & Finance v. Board of Governors of the Federal Reserve System*, 760 F.2d 1135 (11th Cir. 1985) (the *U.S. Trust* case), the U.S. Court of Appeals for the Eleventh Circuit overturned Board approval of the application of a New York bank holding company (U.S. Trust) to expand the activities of its Florida nonbanking subsidiary. U.S. Trust had sought to avoid treatment of the subsidiary as a "bank" under the BHCA by using the nonbank bank device, *i.e.*, the Board's approval was conditioned on the subsidiary's commitment not to make commercial loans. The Eleventh Circuit found that the "technical non-

conformity" with the BHCA's definition of "bank," which permitted U.S. Trust to circumvent the Douglas Amendment's prohibition on interstate ownership of banks, must be disregarded in favor of an examination of the substance of the facility's services and Congressional intent in enacting the prohibition. *Id.* at 1143-44.

The court in the *U.S. Trust* case cited the Third Circuit's decision in *Wilshire Oil Co. v. Board of Governors of the Federal Reserve System*, 668 F.2d 732 (3d Cir. 1981), *cert. denied*, 457 U.S. 1132 (1982), as further support for the principle that the substance of the transaction *must* govern over the form, in light of Congressional intent embodied in the BHCA to prevent the clear circumvention of regulatory limitations. *See* 760 F.2d at 1143-44. The court in *Wilshire* upheld a Board decision that Wilshire Oil Company's financial subsidiary was a "bank" under the BHCA, that Wilshire was therefore a "bank holding company" subject to the Board's jurisdiction and was engaged in both banking and non-banking activities in violation of the BHCA. The device used by the subsidiary for evading the BHCA's definition of "bank" was to change the rules regarding its checking accounts to reserve the right to require 14 days' notice prior to withdrawal of deposits, although it announced its intention not to exercise that right. The court stated:

> While the language of the BHC Act may be the starting point in construing the statute, we may look beyond the plain language, if necessary, to ensure that application of the literal terms does not destroy the practical operation of the statute.

668 F.2d at 735. Going beyond a literal reading of the statute's language, the court held that Wilshire's subsidiary fell "within the category of institutions that Congress intended to include in its definition of 'bank'," *see id.* at 737-38, and that the Board had "properly 'penetrat[ed] the form of the contracts to the underlying substance of the transaction'," *see id.* at 740 (quoting *Plant City*).

Similarly, in a case involving the legal status under the National Bank Act of automated teller machines employed by

national banks to dispense cash and accept customer deposits ("CBCT's"), the D.C. Circuit court in *IBAA v. Smith*, 534 F.2d 921 (D.C. Cir.), *cert. denied*, 429 U.S. 862 (1976), stressed that the conduct of the parties and the practical nature of their relationships, not the formal structure of their private contractual agreements, must determine the nature of the transaction for review of statutory compliance. *See id.* at 942. The court further endorsed the principle that the regulatory agency *must* apply the purpose and intent of the statute over its literal terms. *Id.* at 942-44.

The U.S. Courts of Appeals for the Seventh and Eighth Circuits employed the identical substance-over-form analysis of *Plant City* to similarly determine that CBCT's in substance constituted "branches" under the McFadden Act, and therefore were subject to the restrictions on branching contained in the National Bank Act.[4] Even the Tenth Circuit, prior to the *Beehive* decision, endorsed the same principle of statutory interpretation that the form of a transaction should not be permitted to govern over its substance when to do so would frustrate the intent of Congress. *Colorado ex rel. State Banking Board v. First National Bank of Fort Collins*, 540 F.2d 497, 499 (10th Cir. 1976), *cert. denied*, 429 U.S. 1091 (1977);[5] *Otero*

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[4]*See* Illinois *ex rel.* Lignoul v. Continental Illinois Nat'l Bank & Trust Co., 536 F.2d 176 (7th Cir.), *cert. denied*, 429 U.S. 871 (1977) (cash withdrawal from a CBCT is the functional equivalent of a check; CBCT is in substance a "branch"); Missouri *ex rel.* Kostman v. First Nat'l Bank, 538 F.2d 219 (8th Cir.), *cert. denied*, 429 U.S. 941 (1976) (CBCT's in effect receive deposits and credit accounts and are therefore "branches").

[5] The reasoning of the trial court in the instant case was that the *manner* in which Bank's CBCT permitted the withdrawal of prepackaged packets of money . . . and also permitted the transfer of funds from one account to another, did not constitute "checks paid" or "money lent" as those terms are used in 12 U.S.C. § 36(f). Such reasoning in our view unduly emphasizes form at the expense of substance and fails to follow the admonition of the Supreme Court in *Dickinson* that "§ 36(f) must not be given a restrictive meaning that would frustrate the Congressional intent this Court found to be plain in *Walker*

Savings & Loan Association v. Federal Home Loan Bank Board, 665 F.2d 279, 289-90 (10th Cir. 1981) (McKay, conc.); *accord, American Bankers Association v. Connell*, 686 F.2d 953 (D.C. Cir. 1979).

2. The Amended Regulation Y Properly Addresses the Substance of Nonbank Bank Operation.

The amended Regulation Y is fully consistent with the principle that the use of devices designed to evade—or having the effect of evading—prohibitions in the BHCA cannot be relied on to exempt organizations from regulation under the BHCA. The expanded definitions of "demand deposit" and "commercial loan" in Regulation Y are the result of the Board's serious concern over the vast potential for evasion of the BHCA through the use of nonbank banks.[6] The Board's action in amending Regulation Y is a necessary and proper response to the threat of nonbank banks. From the standpoint of the regulatory purposes of the BHCA, if nonbanks operate for all practical purposes as banks—offering checking services to the public, making business loans, enjoying discount window access and federal deposit insurance, as well as access to the payments system—the BHCA requires that they be regulated as banks.

Contrary to the Tenth Circuit's opinion below, the expanded definitions in Regulation Y do not represent "drastic changes" in the Board's position as regulator. Rather, the Board's actions were made necessary by the "avalanche of applications" to establish nonbank banks that have been filed with the Board and the Comptroller's Office in the last two years. *See Florida Department of Banking v. Board of Governors*, 760 F.2d at

> *Bank* [citation omitted]." The Congressional intent referred to in *Walker Bank* was to place national and state banks in a position of "competitive equality" insofar as branch banking is concerned.

540 F.2d at 499.

[6] *See* Florida Dept. of Banking v. Board of Governors, 760 F.2d at 1138 (quoting Board's order of March 23, 1984 approving U.S. Trust application).

1138. The drastic change from prior Board policy would have occurred if the Board had *not* acted, thereby permitting departure from the traditional federal regulatory scheme imposing controls on concentration of banking resources and commingling of banking and nonbanking activities.

3. Congress Has Delegated to the Board the Exclusive Authority to Interpret 12 U.S.C. § 1841(c).

The Board has the power to issue regulations "necessary to enable it to administer and carry out the purposes of [the Act] and prevent evasions thereof." 12 U.S.C. § 1844(b). Moreover, this Court has recently reaffirmed that the Board is "an authoritative voice on the meaning of a federal banking statute." *Northeast Bancorp, Inc. v. Board of Governors of the Federal Reserve System*, ____ U.S. ____, ____, 53 U.S.L.W. 4699, 4701-02 (U.S. June 10, 1985) (citing *Securities Industry Association v. Board of Governors of the Federal Reserve System*, ____ U.S. ____, 104 S.Ct. 3003 (1984)). Great deference is due to the Board's interpretation of a term in the BHCA designed to effectuate the underlying purposes of the Act.[7]

The Board also has the power to issue interpretations of statutory terms to address circumstances not anticipated when the statute was drafted. *See In re Permian Basin Area Rate Cases*, 390 U.S. 747, 784 (1968) ("administrative authorities must be permitted . . . to adapt their rules and policies to the demands of changing circumstances"), *quoted in Motor Vehicle Manufacturers Association of the United States v. State Farm*

[7] *See* Board of Governors of the Federal Reserve System v. Investment Co. Institute, 450 U.S. 46, 56 (1981) (Board's construction of provisions of the BHCA entitled to the "greatest deference"); Board of Governors of the Federal Reserve System v. First Lincolnwood Corp., 439 U.S. 234, 251 (1978) (Board's interpretation of its mandate under BHCA entitled to deference when that construction accords with Congressional goals); Board of Governors of Federal Reserve System v. Agnew, 329 U.S. 441, 450 (1947) (Rutledge, J., conc.) (Board's judgment construing Glass-Steagall Act conclusive on any matter open to reasonable difference of opinion; deference due to Board's specialized experience); Wilshire Oil Co. v. Board of Governors, 668 F.2d at 736 (construction of statute by those charged with its administration is entitled to substantial deference).

Mutual Automobile Insurance Co., 463 U.S. 29, 42 (1983); *cf. Consumers Union of United States, Inc. v. Heimann*, 589 F.2d 531, 534 (D.C. Cir. 1978) (it is proper to look beyond plain meaning of statute "notably when there is an assertion of a significant change in circumstances"); *IBAA v. Smith*, 534 F.2d at 943, 944 (broad definition of "branch" provides "flexibility necessary to adapt [the] statute to the technological innovations of the computerized Seventies"; construction of statute must be broad enough to encompass traditional banking functions carried out through technologically innovative mechanisms).

It is imperative that the federal banking regulatory agencies retain the power to respond with flexibility to banking innovations in order to preserve the basic objectives underlying the scheme of federal bank regulation, because

> a debating body such as Congress [cannot] respond swiftly enough with regulations to accommodate the sophisticated devices designed by depository institutions to circumvent comprehensive legislation.

Otero Savings & Loan v. Federal Home Loan Bank Board, 665 F.2d at 289-90 (McKay, conc.). The amendments to Regulation Y constitute a valid exercise of the Board's discretionary authority to bring within the BHCA's regulatory framework the myriad sophisticated devices employed by organizations seeking to circumvent regulation.[8]

[8]The Board furnished a lengthy articulation of the bases for the expanded definition of "bank" under the BHCA. *See* Regulation Y, Supplementary, Information, *supra*, 49 Fed. Reg. at 833-42. Throughout, the Board demonstrated the dramatic extent to which organizations have already employed new mechanisms to maximize the benefits of operation as commercial banks while minimizing the impediments of federal and state regulation, so as to gain competitive advantage. The Board explicitly characterized Regulation Y as an attempt to minimize the distortions created by these recent developments. *See, e.g., id.* at 842:

> Now that conditions have changed so that widespread evasion of the statute has developed through the combination of demand deposit-taking and the placing of funds thus generated in money market commercial loans, regulatory action to apply the Act to all kinds of demand deposits and commercial loans is necessary.

Consider the Board's dilemma in attempting to control the proliferation of nonbank bank devices and the wholesale circumvention of the safeguards of the BHCA. First, it sought to recognize and treat NOW accounts as the practical equivalent of demand deposit accounts under the BHCA's "bank" definition. The Tenth Circuit in the *Beehive* case reversed the Board and held that the Board could not do so without the promulgation of a substantive rule. *First Bancorporation* v. *Board of Governors*, 728 F.2d at 438. The Board issued revised regulation Y in order to clarify the definitions of "demand deposits" and "commercial loans" under the BHCA. The Tenth Circuit again reversed, holding this time that the Board had exceeded its authority in interpreting 12 U.S.C. § 1841(c). *Dimension Financial Corp.* v. *Board of Governors, supra*, 744 F.2d at 1410. Pursuant to the Tenth Circuit's directive in *Beehive*, the Board reluctantly approved U.S. Trust's nonbank bank application, only to then be told by the Eleventh Circuit that it should have disapproved the application pursuant to the Board's power under 12 U.S.C. § 1844(b) to "prevent evasion . . . of the fundamental purposes of the Act." *Florida Department of Banking* v. *Board of Governors*, 760 F.2d at 1143.

The Tenth Circuit is clearly wrong in its narrow view of the Board's discretionary authority to interpret the BHCA. In the *U.S. Trust* case, the Eleventh Circuit properly interpreted and applied the legislative history of the BHCA and its consistent judicial interpretation prior to *Beehive* and *Dimension* to permit the Board, if necessary, to go even further to prevent evasions of the Act.

B. The Amended Regulation Y is Consistent with Congressional Intent in the BHCA and the Overall Federal Bank Regulatory Scheme.

Congress' three major purposes in adopting the BHCA and its various amendments were: (1) to prevent the "concentration of banking resources in the hands of a few financial giants" and the consolidation of banking facilities within a

particular area; (2) to guard against the potential abuses inherent in the commingling of banking and nonbanking enterprises; and (3) to prohibit the creation of interstate deposit-taking networks except as specifically authorized by state law.[9] *See Lewis v. BT Investment Managers, Inc.*, 447 U.S. 27, 46 (1980); *Florida Department of Banking v. Board of Governors*, 760 F.2d at 1141.

The potential for concentration of financial resources has been a chief concern of Congress since the 1930's. The controls on concentration contained in the BHCA further the overall congressional objectives of promoting competition in national credit markets,[10] and protecting both individual depositors and the entire financial system from sharp and unintended contractions in the money supply due to bank failures.[11] Congress has sought to restrict joint control over banking operations and nonbanking activities because of potential abuses, such as favoritism in commercial lending toward banks' commercial and industrial affiliates, tying arrangements requiring bank customers to purchase goods and services of banks' commercial affiliates, improper risk-taking by banks, and conflicts of interest. *See, e.g.*, S. Rep. No. 1084, 91st Cong., 2d Sess., *reprinted in* 1970 U.S. CODE CONG. & AD. NEWS 5519, 5521-23. Statutory limitations on interstate banking are designed to further a

[9]The BHCA's limitations on interstate banking parallel the limitations on branch banking of the McFadden Act, 12 U.S.C. § 36. This Court in *First National Bank in Plant City v. Dickinson, supra*, conclusively established that the dual banking system was intended to foster "competitive equality" between federally chartered banks on the one hand and state banks on the other, and that the mechanism selected to achieve this goal was referral to state regulation on the question of branching. 396 U.S. at 131, 133. The Douglas Amendment to the BHCA, 12 U.S.C. § 1842(d), is part and parcel of the dual banking structure, and similarly supports state control over state banking structure. *See* Florida Dept. of Banking v. Board of Governors, 760 F.2d at 1141.

[10]*See* Lewis v. BT Investment Managers, Inc., 447 U.S. at 46.

[11]*See* Scott, The Patchwork Quilt: State and Federal Roles in Bank Regulation, 32 Stan. L. Rev. 687, 696 (1980).

consistent Congressional policy favoring state control over local bank structure by deferring to the states the decisions on entry by out-of-state banking organizations and the availability and expansion of branches. *See Northeast Bancorp, Inc. v. Board of Governors*, 53 U.S.L.W. at 4703.[12]

When a device formulated solely to take advantage of a technical loophole in the definition of "bank" under the BHCA — and which admittedly serves no other purpose — effectively undermines any one of the three basic policies of the BHCA, the bank regulatory *system* cannot tolerate the evasion. In the *U.S. Trust* case, the court refused to be bound by a literal reading of the Act that was plainly at variance with Congressional policy and that would produce absurd results:

> [W]e now consider the question of whether it is reasonable to conclude that Congress intended in 1970 to destroy the Douglas Amendment by adopting an amendment to the definition of bank which would permit bank holding companies to establish an unlimited number of deposit-taking banks across state lines without state approval . . . *We cannot persuade ourselves to employ literalism in statutory interpretation in order to bootstrap Congress' technical amendment* of the definition of bank—after being told that the amendment would apply to only a single

[12]This Court recently spoke authoritatively on the subject of the purposes of the Douglas Amendment to the BHCA and the McFadden Act. In the *Northeast Bancorp* case, the Court reaffirmed that Congress intended to allow states flexibility in their approach to interstate banking, and that a primary objective of the BHCA is to "retain local, community-based control over banking." 53 U.S.L.W. at 4703. The Court quoted with approval a commission's report to the Connecticut General Assembly that characterized the federal system of bank regulation as a "pluralistic banking system," designed to preserve a close relationship between the sources of credit and the small and medium-sized businesses, as well as individual citizens, that are in need of credit. *Id.; accord*, Florida Dept. of Banking v. Board of Governors, 760 F.2d at 1143 (federal policy favors state control over expansion of out-of-state bank holding companies; "local funding of local projects is a significant and important incident of state control over banking").

> institution—*into a total emasculation of the long held policy giving states control over bank expansion.*

760 F.2d at 1141 (emphasis added).

The foundation of the court's reasoning in *U.S. Trust* is that Congress could not have intended such wholesale evasion of the BHCA's limitations on interstate banking in the absence of any clear expression of such intent. *See id.* at 1142. The various forms of nonbank banks are all designed to skirt one or another of the major restrictions of the BHCA —limits on concentration, limits on commingling of banking and nonbanking activities, or limits on interstate banking. The Board's goal in amending Regulation Y was to interpret and clarify the definition of "bank" in such a way that those institutions engaging in activities that were intended to be included in the coverage of the BHCA do not evade the Act's clear restrictions. Very clearly, the sole purpose of any nonbank bank is to circumvent one or another limitation contained in the BHCA. The only purpose in forswearing either commercial lending or traditional demand deposits by these organizations is to avoid the limitations on interstate banking or the separation of banking and commerce set forth in the Douglas Amendment.[13]

The Board's attempt to restore regulatory equilibrium by including in the coverage of the BHCA financial institutions that offer deposit accounts that operate as demand deposit accounts and engage in transactions that establish a debtor-creditor relationship with commercial enterprises was a proper

[13]The court in *IBAA* v. *Conover*, specifically addressed this issue:

> The Comptroller does not serve the public interest by issuing charters to nonbank banks when their only conceivable purpose is to enable their parent companies to escape regulation under the BHCA.

Memorandum Opinion and Order on Defendant's Motion to Dismiss and on Plaintiff's Motion for Preliminary Injunction, IBAA v. Conover, No. 84-1403-CIV-J-12, slip op. at 39 (M.D. Fla. Feb. 15, 1985).

exercise of its discretionary authority. The Board must have the authority to act swiftly and decisively to keep pace with financial sector innovations "in order to avoid the preemption of Congressional discretion through actions that have the effect of evading the [BHCA]." *See* Regulation Y, Supplementary Information, *supra*, 49 Fed. Reg. at 842.

V
CONCLUSION

The decision of the U.S.Court of Appeals for the Tenth Circuit below improperly exalts a literal reading of one section of the BHCA over the purpose of the Act itself, and unwisely disregards the fundamental objectives of the entire scheme of federal bank regulation. This Court must uphold the Board's necessary actions to preserve and protect the integrity of the BHCA and the federal structure of bank regulation.

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